MORNINGSTAR Wealth

Global Convictions & Outlook

Asset Class Research with a Long-Term Perspective

Morningstar Investment Management LLC
For General Educational Use Only
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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.

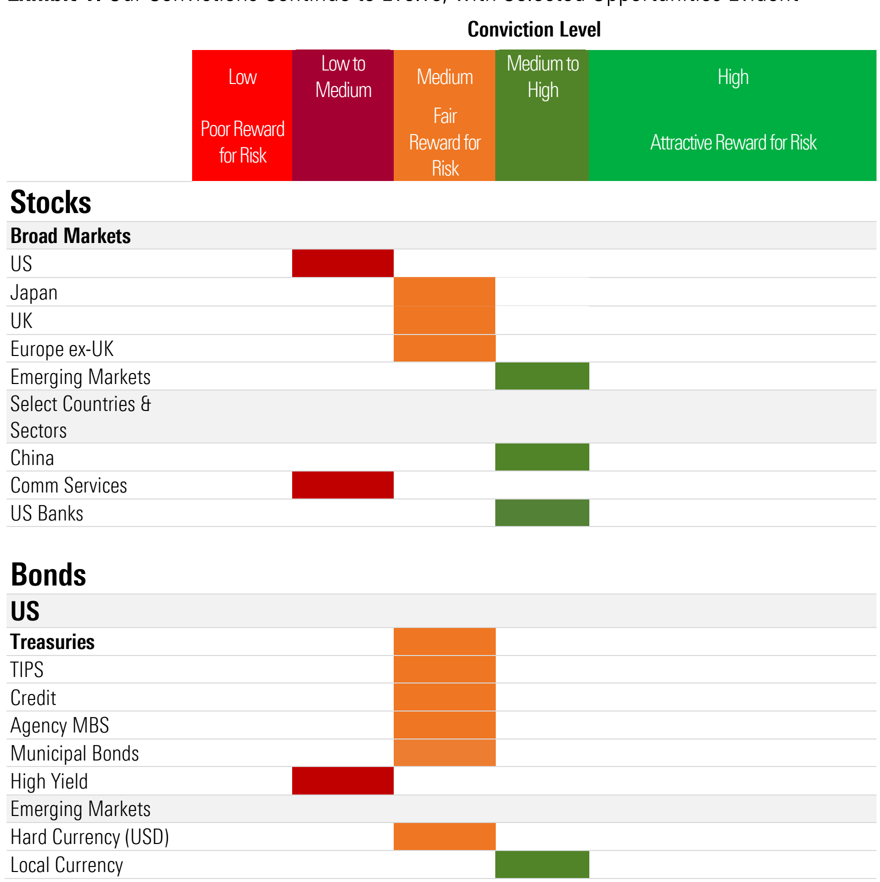
In assigning an asset-class conviction, an analyst trades off the aspects of an investment opportunity that argue for and against it, culminating in the expression of a conviction level. The conviction level is expressed on a five-point scale (Low, Low to Medium, Medium, Medium to High, and High).

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

Global equities surged last year, with US stocks leading, while the bond market posted positive returns, yet failed to outpace inflation. Looking ahead, it's impossible to predict exactly what will happen over the next 12 months. However, it's unlikely that US stocks will replicate their recent performance trends over the long-term. They are the most expensive market globally, with returns concentrated in a few companies, and there has not been a single 10% correction in over a year. In short, optimism is heavily priced into US stocks. The good news? Many equity opportunities exist beyond US stocks.

And while many risks likely lie ahead, this is always the case because the future is unknowable. Common risks that are often cited usually include a new US administration and high equity valuations, but it's important to remember the biggest risks are often events nobody sees coming ahead of time. In our view, the best remedy to risk—whether known or unknown—is a diversified, valuation-driven investment approach.

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



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

Broad Investment Backdrop

It was a wonderful year for US equity investors as the market increased by more than 20%. While US large caps claimed the spotlight, not all asset classes matched their pace. US small caps (+11%), international stocks (+6%), and emerging markets (+8%) delivered positive returns but significantly trailed US large caps, a trend that has been rather persistent in recent years.

It's well known that a few mega-cap stocks have driven most of the market returns in recent years and that has been largely reflected in the outperformance of growth indexes versus value indexes. With that said, signs of broader participation began to emerge in the second half of last year and it will be interesting to continue monitoring that in the year ahead.

From a sector perspective, communication services, financials, and consumer discretionary led the market as the top performers last year. Utilities were close behind—which is rare to see in a bull market— driven by investor interest in their role in powering the rise of artificial intelligence, a dominant market theme. On the other hand, real estate, healthcare, and materials were the year's worst-performing sectors.

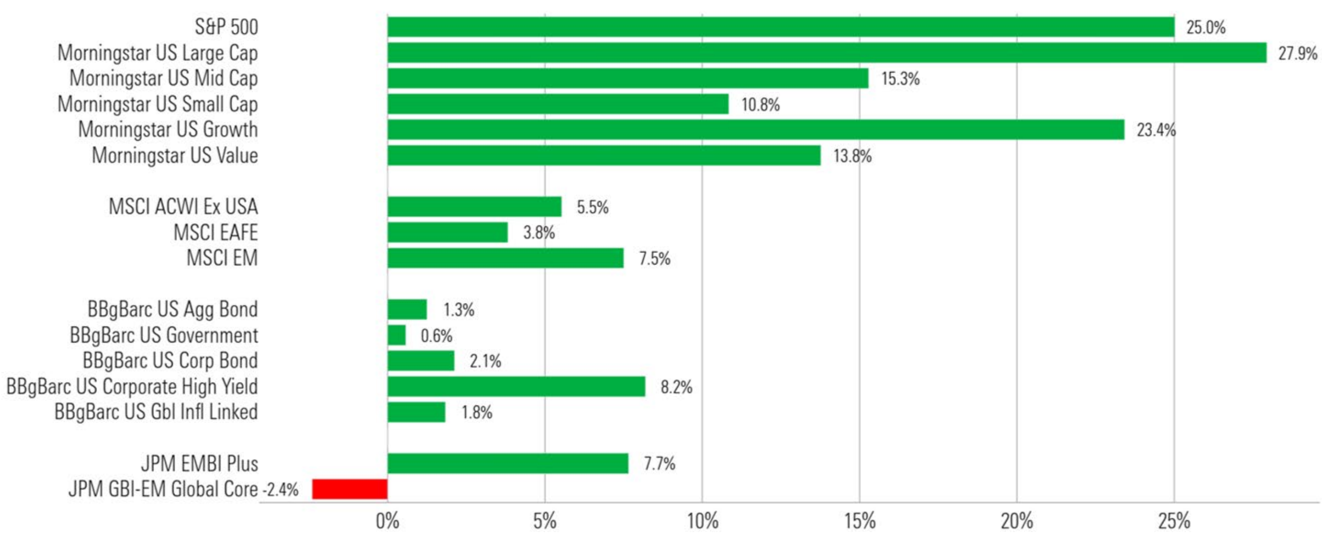
In our view, valuations in many top-performing areas of the market have stretched beyond fair value, warranting caution and potentially greater diversification. Unsurprisingly, many of our highest-conviction opportunities lie in contrarian segments of the market, including:

- Defensive equities, like healthcare and consumer staples
- US banks
- Chinese tech stocks
- Emerging-markets debt
- Government bonds and inflation-protected securities

Many of our high-conviction asset classes trade at valuations that are extremely discounted when compared to the mega-cap stocks. And while valuations are not a timing tool, they offer insight into the expectations embedded in prices. In short, the bar is set exceptionally high for US large caps but less so for other asset classes. We believe this should inform investor thinking about how they position portfolios in the years ahead.

In fixed income, while returns were positive, the year fell short of expectations. The Fed's rate-cutting cycle, which began in September, theoretically should have benefited bonds. However, reality diverged as the 10-year Treasury yield climbed over 100 basis points following the first cut, creating significant headwinds. Looking ahead, with yields at current levels and the potential for additional Fed rate cuts, the outlook for the bond market appears more promising.

Exhibit 2. US Equities Lead in Strong Year for Investors



Source: Clearnomics, Morningstar, MSCI, Bloomberg, JPMorgan, as of December 31, 2024. 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.

Asset-Allocation Research (as of January 2025)

EQUITY MARKETS

Asset Class	Conviction
US Equities	**Low-Medium**
• Consumer Staples	Medium to High
• Banks	Medium to High
• Healthcare	Medium
• Utilities	Low to Medium
• Communication Services	Low to Medium

Rationale

Backdrop

2024 proved to be a stellar encore to 2023. US large-cap stocks finished up nearly 25%, following a gain of 26% in the previous year—one of the rare sequels that surpasses expectations. Notably, it marked the first back-to-back years of 20%-plus gains since 1999, and US large-cap stocks are up nearly 80% since the October 2022 lows. It should also be pointed out that these returns were achieved without sacrificing much scar tissue as US stocks were able to avoid a 10% correction for the entire calendar year.

In short, it's been a smooth ride. The question becomes: Can this continue? While it's impossible to predict a sea change in markets, we believe the best opportunities in US equities aren't necessarily the ones celebrated on the front pages—such as technology stocks or AI-related themes. We've held that the market is likely to become less concentrated over time, though we can't set a stopwatch to it.

As we consider starting valuations—together with our belief that the price you pay for an asset plays a prominent role in long-term investment returns—our most reasonable view is that defensiveness should likely play a more prominent role in portfolios. US large cap stock valuations—measured by the CAPE ratio—sit in the 98th percentile of historical readings, nearing the heights of the 2000 tech bubble. Moreover, the valuation gap between US stocks and the rest of the world is at its widest point in recorded history, dating back to the late 1980s.

While valuations are not a timing tool, they offer insight into the expectations embedded in prices. In short, the bar is set exceptionally high for US large caps but less so for other asset classes. We believe this should influence thinking about portfolio positioning in the years ahead.

Outlook

Our conviction for the US equity market is Low to Medium.

At a deeper level, valuation spreads—the disparity in valuation levels between sectors—is where we see opportunity. 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 more fully valued. However, we acknowledge that a prolonged period of structurally higher commodity prices has not been fully priced into these shares and 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 US banks are still relatively attractive, though not without risk. 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 we are wary of the potential for a crowding situation in the sector, which, in aggregate, has been "over-earning" relative to its own history (meaning, profit margins of late have been elevated versus long-term averages). So, care is required in this space, especially with interest rate rises and valuation multiple implications from those increases. We have recently updated our work on the communication services sector in the US. Despite excellent share returns—most notably Meta. Our updated work suggests that while not as compelling as was the case at year-end 2022, valuations in the sector are still reasonable on an absolute basis and, when compared to other equity asset classes (particularly those in more growth-oriented sectors), are relatively appealing.

All this 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-UK Equities • European Energy • European Financials	**Medium** Medium Medium	**Backdrop** Eurozone equities ex-UK ended the year with a positive return of nearly 7%, despite a decline in the fourth quarter. While solid in isolation, this performance was middle-of-the-pack when compared to other asset classes globally and significantly trailed US equities—a persistent trend. As noted in our US backdrop, the CAPE ratio for US stocks remains near historical highs. In contrast, European equities are more attractively valued, with the valuation gap between US and non-US stocks now at its widest point since the late 1980s. From an investment perspective, Europe's valuations are a compelling reason to maintain exposure to the region. Additionally, Europe's sector and industry composition differs significantly from the US, with a much lower weight in technology stocks. This difference has been a key factor in the relative underperformance of European equities. However, if market leadership shifts, the performance dynamic could favor Europe, offering further diversification benefits to investors. **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 continued macroeconomic concerns. In aggregate, we find German stocks offer solid balance sheets and potential upside to earnings—without eye-popping valuations. At a sector level, we hold positive views on European-integrated energy companies. European banks valuations, on the other hand, have started to moderate.

Asset Class	Conviction	Rationale
UK Equities	**Medium**	**Backdrop** UK equities reflected many of the same trends observed in European equities ex-UK backdrop. The market ended the year with a positive return of nearly 7%, though it faced a decline of approximately 7% in the final quarter. The sector and industry differences between the US and Europe are similarly applicable to the UK, offering valuable diversification opportunities. Notably, the UK equity market boasts one of the highest dividend yields among developed markets. While this is partly due to weaker share prices, it also highlights unique equity income opportunities. Looking ahead, investors should focus on future prospects rather than past performance. Attractive valuations and the UK's distinct industry composition are compelling reasons to consider this market. When combined with macroeconomic tailwinds such as rising GDP, easing inflation, and lower interest rates, the outlook for UK equities could be among the most promising across developed markets. **Outlook** Our overall conviction score for the UK remains at Medium. While relative valuations remain at Medium to High, absolute valuation is Medium. This means our long-standing belief that investors were being well compensated for the risk of investing in UK stocks has softened, coming more in line with international peers. That said, UK equities remain a solid dividend play, where we have seen many companies reinstate their dividends at more sensible and sustainable levels. Revenue is cyclical given the underlying key sectors of financials, energy, and materials—and we don't expect any material changes to this going forward. Both operating and financial leverage are also stable. From a fundamental standpoint, we note that most UK corporates are high-quality businesses.

Asset Class	Conviction	Rationale
Australian Equities	**Medium**	**Backdrop** Australian equities ended the year slightly positive, up nearly 1% in dollar terms. However, a sharp decline of almost 11% in the final quarter erased most of the year's gains. Australia's equity market is heavily influenced by its industry composition, particularly its large materials sector dominated by mining companies. China, a major buyer of Australian commodities like iron ore, coal, and metals, plays a significant role in shaping market outcomes. This dynamic was evident last year: Australian equities rallied in response to Chinese government stimulus in the third quarter but retreated as the impact of that stimulus faded. **Outlook** Australian shares retain a Medium conviction, but financials (and banks specifically) are now firmly pricing in a soft-landing scenario for the economy. Despite this optimism, consumer confidence remains delicately poised with the RBA yet to cut rates. Consumer fears of further interest rate rises have eased, however progress on alleviating cost-of-living pressures has been slow. One good outcome from the tighter monetary stance over the last 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 last decade.

Asset Class	Conviction	Rationale
Japan Equities	**Medium**	**Backdrop** Japan's equity market ended the year up nearly 7%, despite posting a negative return in the fourth quarter. The year was eventful, marked by a major market correction in early August when the unwinding of a popular "carry trade" led to some single-day moves that exceeded the year's total return. Historically, such volatility is not unusual for Japanese equities, which have often alternated between booms and busts rather than enjoying sustained periods of moderate growth. On a positive note, Japan continues to implement reforms aimed at attracting global investors, including government mandates designed to boost company valuations by encouraging greater capital returns to shareholders. One notable shareholder, Warren Buffett, highlighted his interest in Japan, referencing his substantial investments in five major Japanese trading companies and his intent to explore further opportunities. **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
Emerging-Markets Equities	**Medium to High**
• China Equities	Medium to High

Rationale

Backdrop

Emerging markets ended the year with a gain of nearly 7%, despite a decline in the fourth quarter. Zooming out, this marks the seventh consecutive calendar year that US large caps have outperformed emerging-markets. While some investors may view this as a reason to abandon emerging-market equities, we believe such a move could be shortsighted.

China accounts for roughly a quarter of the emerging-markets index, significantly influencing the trajectory of broader emerging-market equities. Stimulus measures introduced by the Chinese government in the third quarter sparked a sharp rally, which later faded as investors seek more answers on the impact of these measures on economic growth and corporate earnings.

Emerging markets rarely follow a smooth path—volatility is a constant factor. However, we find encouragement in recent efforts by Chinese authorities to restore confidence in the economy and incentivize consumers to shift from saving to spending.

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). 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.

Asset Class	Conviction
Global Sectors	
• Financials	Medium
• Communication Services	Low to Medium

Rationale

Backdrop

The global equity narrative, from a sector perspective, is largely defined by the rising dominance of technology, while other sectors have diminished in relative size. Although this is a generalization, it highlights an important reality. Conversely, technology's ascent has created more attractive valuations in other sectors for those willing to look beyond recent performance trends.

As valuation-driven investors, we are always peeling back the layers, attempting to identify sectors that hold some combination of factors (depressed valuations, upward earnings revisions, catalyst, etc.) that might indicate where better opportunities exist. We often tend to think of this as *The Three U's: unloved, underappreciated, and undervalued.* And right now, the opportunities that fit this description exist outside of technology.

Of course, bells never ring to inform us when a market inflection point has been reached, which means we approach each situation cautiously.

Outlook

We continue to see opportunities at the defensive end, as well as financials. Defensive value-oriented areas of the market have struggled, despite generally robust earnings. 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 should be less volatile and less affected by the ups and downs of long-term market cycles. Yet, following weakness, they now present decent valuation opportunities.

FIXED INCOME

Asset Class	Conviction	Rationale
Developed-Markets Sovereign		
• US Treasuries	Medium	
• Euro Government	Low to Medium	
• UK Gilts	Medium	
• Japan	Low to Medium	
• Australia	Medium	

Backdrop

September marked the first Fed rate cut in more than four years, and all signs pointed to an era of lower rates ahead. In theory, this should have provided a favorable backdrop for the bond market, as lower rates generally lead to positive bond returns. Yet, markets love to fool the masses. While the Fed lowered short-term rates in September, long-term interest rates have risen—a surprising twist. The result? Bonds delivered negative returns in two of the three months following the rate cut.

High-quality bonds—represented by the Bloomberg US Aggregate Bond Index—ended the year with a positive return of 1.4%, but this still lagged behind inflation. Moreover, high-quality bonds remain in a drawdown that began in July 2020, making this the longest streak in history at over 50 months, leaving many investors to question the role of this critical asset class.

When performance falters, it’s natural to question everything—that’s human nature. However, there are still compelling reasons to believe that bonds should remain an essential part of portfolios. For instance, the yield curve has normalized and is now flat, after being inverted for much of 2022. This means investors no longer face a yield penalty for extending maturities. With more rate cuts expected this year, longer-maturity bonds offer both income generation and potential price appreciation. In contrast, cash returns are limited to income and could decline further if rates drop due to additional Fed cuts.

In short, bonds appear to offer better value than cash. This has historically been the case, though recent investor flows have favored money-market funds. We believe investors should think twice before using cash as a fixed-income replacement. For example, over the past 35 years, bonds have returned about 400%, while cash has lost nearly 60% after inflation.

Given where yields stand today and the Fed's potential plans for further rate cuts, it's not unreasonable to think there are better days ahead for the bond market.

Outlook

The material increase in bond yields has improved forward-looking prospects, which applies positively to the US, UK, and Australia. Europe is also rising from a very low base, although absolute yields remain broadly unattractive. Yields now cover inflation in many instances, offering positive “real” yields.

Going slightly deeper, the ability to add income to portfolios while mitigating duration/default risk looks attractive to us currently. Healthy government bond yields are a positive for future return generation, and we expect this asset class to continue playing a role for investors. That said, overall, we believe that managing duration risk makes sense in most scenarios. We are cognizant of the potentially sizeable drawdown risk from longer-duration assets and adjusting our bond allocations higher at a moderate pace. 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 and the threat of stickier inflation. The key risk for fixed income is that interest rates fail to sufficiently slow economic growth and inflation.

For corporates, many firms are using free cash flow to fund capex, not debt, and service-oriented firms are less reliant on debt financing than industrials. At the consumer level, most mortgages have locked in lower rates, and while we are seeing signs of slowing housing activity, the risk of a collapse is relatively contained. 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 persistent inflation that has the potential to reduce aggregate demand. To complicate matters, central banks have been late to make decisions to address inflation, which could ultimately lead them to a tough bridge—balancing between a hard and soft landing. Further, given the delicate nature of both the domestic and global economies, 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	Rationale
Investment-Grade Credit		**Backdrop**
• US	Medium	Much of the discussion surrounding developed-market sovereign bonds also applies to investment-grade (IG) bonds. IG bonds delivered a modest return for the year, up nearly 1%, but retreated significantly in the fourth quarter, falling by more than 4% as rates rose.
• European Corporates	Medium	That said, we continue to believe that investment-grade bonds remain an invaluable component of investor portfolios. The potential for declining interest rates, combined with the higher yields currently available, should provide a strong benefit moving forward.
• UK Corporates	Medium	**Outlook**
• Australian Corporates	Medium	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 remain below where they should be, in our analysis, and 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 Medium	**Backdrop** High-yield bonds were the only fixed-income category to deliver a positive return in the fourth quarter, finishing up 0.1% and capping off a yearly return of nearly 8%. Generally, the high-yield bond market in the US and Europe offers yields in the high single digits, and in some cases, low double digits. While these bonds carry higher risks, their advantages become more apparent when managed with a diversified portfolio that includes high-quality bonds. **Outlook** Our overall conviction is Low to Medium. In our view, this bears watching. 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 • Hard Currency	 Medium to High Medium	**Backdrop** Emerging-markets bonds had a strong year, finishing up more than 6% in dollar terms, which includes a more than 2% decline in the fourth quarter. While the risks of emerging-markets bonds are discussed frequently, they also provide meaningful diversification benefits, especially considering the higher yields compared to other parts of the bond market. Like high-yield bonds, headline yields in emerging-market bonds remain enticing, typically in the high single-digit range. For example, Brazil's 5-year bonds yield around 14%, while Mexico's 10-year bonds yield approximately 10%. Both offer attractive real yields, considering inflation rates hover around 4%. While emerging-markets bonds carry more risk than other parts of the bond market, there is a substantial yield cushion in place. This reflects the reality that many emerging-markets central banks have raised interest rates far more than their developed market counterparts to combat inflation pressures. As the inflation outlook in most emerging-markets countries continues to improve, so has the resilience of the asset class. **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 buildout 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) were positive for the year, with a gain of 1.3%, although they experienced a decline of more than 3% in the final quarter of the year. The MBS market still presents an interesting investment opportunity as new issuance (supply) is 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. From an investment perspective, the lack of new supply should create interesting opportunities to selectively own this asset class. **Outlook** Overall, 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 no inherent default risk. That said, further spread widening may take place before it turns in investors' favor should the economic environment turn sour.

Asset Class	Conviction	Rationale
Global Inflation-Linked Bonds • US TIPS	 Medium	**Backdrop** Treasury Inflation-Protected Securities (TIPS) ended the year with a gain of around 2%, although they saw a nearly 3% decline in the final quarter as rates rose. Despite this, TIPS ranked in the top half of fixed-income categories for annual returns. Inflation data has been moving in the right direction (lower), but it remains a very real concern. And a key point to remember is that TIPS generally protect against *unexpected* inflation, meaning if there was an inflationary event, this asset class would be a potential winner. **Outlook** TIPS should eventually benefit from higher interest rates, and it wouldn't take much for markets to re-price inflation, which could offer upside. 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 posted a modest gain of just over 1% for the year, although they experienced a slight decline in the final quarter as rates rose. Generally, municipal bond yields have increased with the broader bond market, and credit fundamentals remain solid. Record employment and increasing wages (especially *real* wage growth) have bolstered tax receipts. Home values, a factor in property tax revenues, continue to hold up as low levels of inventory have proven to be more important than high mortgage rates. **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.

OTHER ASSETS

Asset Class	Conviction	Rationale
Global Infrastructure	**Medium**	**Backdrop** Global infrastructure represents a wide collection of income-producing assets, which includes utilities, airports, rail, and energy-related holdings. Global infrastructure indexes delivered mid-teens returns for the year, with utilities benefiting from AI datacenter growth and transportation infrastructure stocks posting more modest gains. 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 up 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.
• US Energy Infra & MLPs	Medium	

Asset Class	Conviction	Rationale
Listed Property		**Backdrop** US real estate equities ended the year up more than 5%, but gave up significant gains in the fourth quarter, declining by approximately 8%. The biggest swing factor for real estate has been the path of interest rates. In the late summer, when it became apparent that interest rate cuts were coming, real estate was one of the best performing sectors in the market. However, as markets often do, they love throw curveballs. And though we saw the first rate cut in September, long-term interest rates proceeded to rise (not fall) which dampened the mood for real estate. **Outlook** REITs continue to remain dually exposed to economic conditions—both from a top-line rental growth perspective and a funding conditions perspective. As trusts that pay out high levels of earnings as dividends, REITs rely heavily on debt (and equity) markets to fund their highly capital-intensive operations. 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.
• US REITs	Medium	
• Global REITs	Medium	

Alternatives
Alternatives continue to provide a nice ballast, though the impact is less pronounced when strong equity returns are present. 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 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 continue to see merit in currencies outside the US dollar. 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, 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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Common stocks are typically subject to greater fluctuations in market value than other asset classes as a result of such factors as a company's business performance, investor perceptions, stock market trends, and general economic conditions. Investing in international securities involves additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may increase these risks. Bonds are subject to interest-rate risk. As the prevailing level of bond interest rates rise, the value of bonds already held in a portfolio declines. Portfolios that hold bonds are subject to fluctuations in value due to changes in interest rates. Diversification and asset allocation are methods used to help manage risk; they do not ensure a profit or protect against a loss.

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