MORNINGSTAR Wealth

Global Convictions & Outlook

Asset Class Research with a Long-Term Perspective

Morningstar Wealth
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For Professional Clients

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.

Investors will likely be happy as they review their statements in early 2024. Nearly all traditional asset classes have generated positive returns in recent memory, boosted by performance across European equities, global equities, and global bonds.

The strength is largely driven by the expectation central banks will cut interest rates in 2024 as the worst of the inflation spike is now considered behind us. Several equity markets now sit at or near all-time highs, including Japan, France, Brazil, India, Mexico, and many others in local currency terms.

Despite this rally, we remain cautiously optimistic. Our approach in this environment is to balance risk and opportunity, with some asset classes looking attractive to us at the current time.

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

	Conviction Level				
	Low Poor Reward for Risk	Low to Medium	Medium Fair Reward for Risk	Medium to High	High Attractive Reward for Risk
Equities					
Broad Markets					
U.S.			■		
Japan			■		
U.K.			■		
Europe ex-U.K.			■		
Emerging Markets				■	
Select Countries & Sectors					
Communication Services			■		
Germany			■		
China				■	
Global Energy		■			
U.S. Banks				■	
Bonds					
U.S.					
Treasuries			■		
TIPS			■		
Credit			■		
High Yield			■		
Agency MBS				■	
Municipal Bonds			■		
Emerging Markets					
Hard Currency (USD)			■		
Local Currency				■	

Source: Morningstar Investment Management. Views as of 25th January 2023 and subject to change. For illustrative purposes only. References to specific asset classes should not be viewed as a recommendation to buy or sell any specific security in those asset classes. Conviction is subject to change at any time without notice.

Looking Ahead

As we enter 2024, it's essential we remind investors that the presence of uncertainty does not imply a scarcity of opportunities.

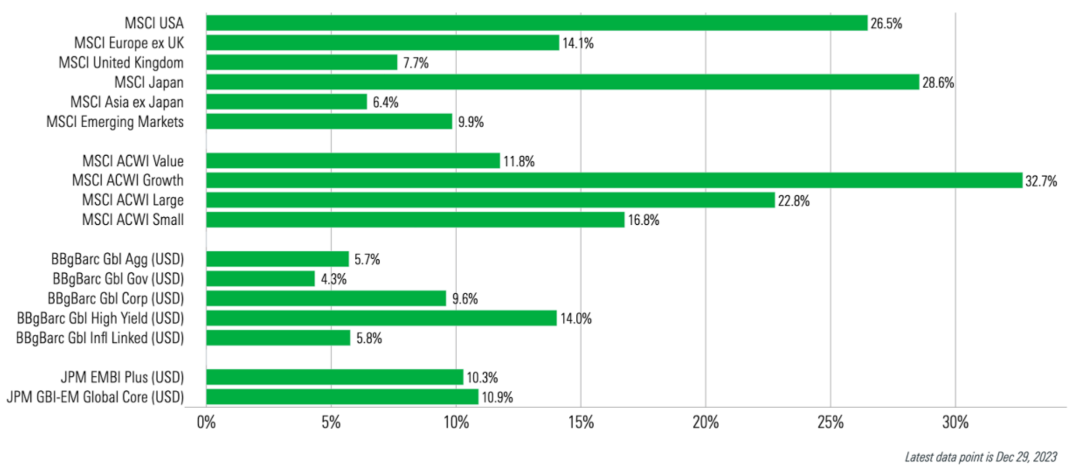
To that end, we see positives in this environment, with opportunities to add value in fixed income and select equity markets, among other ideas. A short list of our convictions include:

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

Of course, the path of interest rates and inflation will continue to act as key talking points among investors. Let's not forget that investors went into 2023 worried about inflation and expecting a recession by the second half of the year. This never transpired. Now in 2024, investors are expecting low inflation, no recession, and significant interest rate cuts. This is a goldilocks-like scenario, if it plays out, but it's worth bearing in mind that it is far from guaranteed.

Most investors have long-term goals (such as retirement) and should therefore focus on long-term value creation. Similarly, it is worth noting that risk management is a critical pillar of successful investing. An effective risk management strategy balances investment opportunities with future uncertainty, equipping investors to navigate through market volatility.

Exhibit 2. 2023 Yearly Returns Were Positive Across the Major Market Indexes



Source: Clearnomics, Morningstar, MSCI, Bloomberg, JPMorgan, as of 1st January 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 2024)

EQUITY MARKETS

Asset Class	Conviction
U.S. Equities	**Medium**
• Consumer Staples	Medium
• Healthcare	Medium
• Energy Infrastructure	Medium
• Banks	Medium to High
• Communication Services	Medium

Rationale

Backdrop

U.S. stocks put a bow on a strong year, finishing up 26%—measured by the S&P 500—which was good for the 14th best calendar year return since 1970. Investors breathed a sigh of relief as the painful memories of 2022 moved further into the rearview mirror, the economy remained resilient, inflationary pressures ebbed, and rate hike expectations morphed into rate cut expectations. However, those strong gains were not evenly distributed. Growth stocks—typically higher valuation, more expensive companies—sucked up most of the oxygen, while everything else fought for air. Per Bloomberg data, 72% of the stocks that make up the S&P 500 trailed the index's stated return, which was the highest number of companies underperforming the index in multiple decades. Despite increased participation in Q4's broad rally, on balance the US equity market performance in 2023 was indeed top-heavy and dominated by a select few mega-cap growth companies, notably the "Magnificent 7". This trend will be interesting to continue to monitor. Growth stocks beat value stocks by the second widest margin in 20 years last year. Can that trend continue?

Using history as a guide, it's hard to believe it can, though we admit calling for inflection points in markets is a little bit like trying to predict the weather. But as we ponder last year in totality, we should remind ourselves a recession was a consensus expectation, but it never materialised. That likely serves as a useful framework to think about markets going forward. It's possible the current consensus expectation—growth stocks being unimpeachable—may not be correct either. As valuation driven investors, we believe some of the most compelling U.S. equity opportunities exist outside of the technology sector and other *hot* areas of the market.

Outlook

It's important to note that our conviction for the U.S. equity market 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. 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—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 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, 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-U.K. Equities • European Energy • European Financials • Germany	**Medium** Medium Medium Medium	**Backdrop** Eurozone equities capped off a solid year, but the final results (mid-teens returns) were not as exciting as U.S. equities—a stubborn trend that continues to hold in recent times. The sector and industry composition in Europe is much different than the U.S. For example, the weight in technology stocks is 20% higher in the U.S. This has been a significant factor in U.S. stocks outpacing European stocks. From an economic standpoint, Europe's largest economy—Germany—has been dealing with an economic slowdown, and this problem has filtered through equity markets. But the *problem* also creates attractive valuations and potentially interesting investment opportunities. Thinking through investment opportunities, we believe the price you pay is often the single biggest determinant in the outcome. When U.S. equities (specifically large cap) are discussed, it's not uncommon to hear they're *"priced for perfection."* That's not the case in Europe and one of the reasons we continue to pay close attention to the asset class. **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
U.K. Equities	**Medium**	**Backdrop** U.K. equities generally mimicked the path of Eurozone equities broadly, finishing the year with decent positive returns. Our discourse on the sector and industry differences between the U.S. and Europe holds true for the U.K. as well. The U.K is charting a slower path of GDP growth, like Germany, and has yet to see GDP get above the levels observed pre-pandemic. The battle with inflation has improved—U.K. inflation was above 10% last March but fell below 4% through November—and has created more optimism among consumers. From an investment perspective, relative valuations remain attractive and the differences in industry composition versus the U.S. keep it interesting from a diversification standpoint. **Outlook** Our overall conviction score for the U.K. remains at Medium. While relative valuations remain at Medium to High, absolute valuations is Medium. 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, U.K. 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 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 were positive performers last year—returning low-teens—but lagging many other developed equity markets. Relative to others, Australia didn't get the "tech tailwind" as their largest industries are the financial sector and materials sector, while having a very small percentage of their equity market comprised in technology. Additionally, the slowdown in China has impacted Australia more so than others as they're China's largest trading partner, providing China with many of the natural resources (iron ore, coal, metals, etc.) they need to grow and maintain their economy.

If and when China's trajectory changes, it would be fair to expect Australia's to change as well. But for the time being, the economic backdrop continues to be muted GDP growth.

Outlook

Headwinds exist, but performance last year relative to the major global indexes was subdued. 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 Chinese Equities on valuation grounds, and other select emerging markets.

Asset Class	Conviction	
Japan Equities	**Medium**	**Backdrop** Japan was one of the best performing equity markets in the world last year, beating the S&P 500—in local currency—and finishing up more than 28% for the year. In the process, Japanese equities—measured by the Nikkei 225—hit their highest levels in more than 30 years. A couple items underpin the success in Japan. There's a structural element: Japan's government has been getting serious about reform. One example was the Tokyo Stock Exchange (TSE) ordering all listed companies trading at below book value to get serious about correcting that, otherwise risk being delisted. Put simply, if a company is trading below book value, the market is indicating the company is worth less than the physical assets they hold. From an investment perspective, Japan hopes these reforms will bring more foreign investment. To date, they've already captured one big investor: Warren Buffett, who mentioned last year, "*we'll keep looking for more opportunities in Japan"* while referencing Berkshire's significant investments in five Japanese trading companies. The history of Japanese equities has mostly been defined by booms and busts—there haven't been many *relaxing* periods of moderate growth. But investors might be well served to know that material changes are occurring to reshape their markets. It's too early in this transition to wager on a specific outcome, however, it does appear fundamentals are improving, and investors would be wise to continue paying attention. **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 has adjusted its prolonged quantitative-easing program, a step toward interest-rate normalisation.

Asset Class	Conviction	Rationale
Emerging-Markets Equities • China Equities	**Medium to High** Medium to High	**Backdrop** Emerging-markets finished the year positive, up low double-digits. It's important to keep in mind China makes up nearly 30% of the index and plays a heavy hand in determining the asset classes fate in any single year. Last year, China's performance suffered, and the result was dragging down the performance in emerging markets. The caveat would be: Negative Chinese equity performance was mostly a result of government intervention, and not driven by fundamental business performance. The result? We think China may be more attractive than conventional wisdom would indicate. The structural story around emerging markets remains intact. Collectively, these countries represent approximately 80% of the world's population and nearly 70% of the world's GDP growth, but less than 10% of the total global equity market cap. A burgeoning middle class continues to develop and should present interesting opportunities for investors, albeit with higher volatility. As a nod to Charlie Munger's old investing quote, *"fish where the fish are"* we should keep in mind *plenty of fish* exist in emerging markets. **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). Emerging markets as a whole continue to offer attractive valuations, with a forward price/earnings ratio of 11.9x, well below developed world peers.

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

Rationale

Backdrop

As Newton's third law states, *"Every action has an equal and opposite reaction".* AI-adjacent companies—mostly technology—rocketed higher last year, however, valuations for other global sectors got cheaper.

Much ink has been spilled discussing the Magnificent Seven (including by us!), but the S&P 493 (excluding the Magnificent Seven) is much more reasonably priced from a valuation perspective. Continuing to peel back the layers and look at individual sectors, opportunities should continue to emerge. Unfortunately, a bell never rings to inform us when a market inflection point is reached, which means we need to approach each situation cautiously.

But the market action we saw last year should create interesting long-term investing opportunities at the sector level. For example, the energy market was one of the worst performing sectors last year. But as war rages in the Middle East and problems arise in important shipping lanes between Asia and Europe, there's a chance some sectors are not fully pricing in different outcomes.

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

Rationale

Backdrop

The bond market has not provided the defensive features over the past two years that investors had come accustomed to setting their watch too. Using the Bloomberg Aggregate Bond Index, bonds have been in a drawdown for more than 40 months, the longest drought in history. As the saying goes, *"but other than that, how was the play Mrs. Lincoln?"* The good news? After spending much of the year in negative territory, the Bloomberg Agg had its best single month gain in more than 40 years in November, finishing up 4.5% for the month. After a painful period of rate hikes, it appears the market began to price in the idea that rate cuts were on the horizon.

Given where yields sit today, it's not unreasonable to believe the worst could be behind us. A key aspect of the bond market is that interest rates adjusting higher from zero hurts most at the beginning, like we saw in the past few years. Any increase in rates from where we sit today will likely be much less dramatic than what already happened (i.e., going from 0% to 5%) for the simple fact that you're getting paid a coupon now that isn't replicated with 1%–2% yields. In short, higher yields will ultimately translate to higher future expected 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. 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 feel that managing duration risk makes sense in most scenarios. We are cognisant 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 that 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 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	Medium
• U.K. Corporates	Medium
• Australian Corporates	Medium

Rationale

Backdrop

Investment-grade bonds delivered a nice result for investors last year, finishing up high-single digits. Similar to high-yield bonds, a furious late year rally—November was one of the best month's ever for a popular U.S. investment-grade bond ETF—masked some of the volatility that was observed in the early part of the year. Generally, investment-grade bonds continue to be a valuable asset class for portfolios. They offer higher yields than government bonds (given greater credit risk), although the "spread" between the two remains relatively tight given the environment. But after a painful adjustment to higher yields—2022 was a historically bad year—investment-grade credit now offers some of the most attractive levels of income in more than a decade.

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 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 • U.S. High Yield • European High Yield	 Medium Medium	**Backdrop** High-yield bonds had their strongest year of performance since 2019, returning low double-digits for the year. The final result hides some of the messy intra-year details, as nearly 70% of the year's total returns came during November and December. Parts of the high-yield bond market in the U.S. and Europe still offer yields in the high single digits, and in some cases, low double digits. Risks are 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** Our overall conviction is 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** After two painful years, emerging-market bonds got back on track last year, finishing up high-single digits or low double-digits, depending on the currency. Like high-yield bonds, headline yields in emerging-markets bonds are at enticing levels, in the high single-digit range. While emerging-market 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 in excess of 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 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
U.S. Agency MBS	**Medium to High**	**Backdrop** The path was difficult, but U.S. mortgage-backed securities (MBS) were able to avoid a third consecutive negative return year, finishing up mid-single digits. Through October, MBS were actually negative—in the mid-single digits—but benefitted from a furious November and December rally to finish the year positive. The MBS market is likely more interesting than any time in the past decade. Why? 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 U.S, today is around 3.7%, while the rate on a new mortgage rate is around 7%. Given that backdrop, refinancing has grinded 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' favour should the economic environment turn sour.

Asset Class	Conviction	Rationale
Global Inflation-Linked Bonds • U.S. TIPS	 Medium	**Backdrop** Treasury Inflation-Protected Securities (TIPS) participated in the late year rally and finished the year up mid-single digits. During the painful bond market drawdown in 2022, TIPS didn't serve as an inflation hedge, which was confusing to many investors with inflation at decade highs. The reason? TIPS generally protect against *unexpected* inflation. As we move forward, TIPS could be an interesting asset class, especially if conflict in the Middle East causes any disruptions in oil supply, causing prices to rise. **Outlook** TIPS should eventually benefit from higher interest rates, and it wouldn't take much for markets to reprice 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
U.S. Municipal Bonds	**Medium**	**Backdrop** Municipal bonds were solid performers on the year, finishing up mid-single digits, and the return came with less volatility than other parts of the bond market. Generally, municipal bond yields have increased with the broader bond market, and credit fundamentals continue to look 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 indices delivered flattish returns for the 2023 calendar year, with indices tilted towards transportation infrastructure faring better than indices with a heavier weight held in utilities. Within transportation infrastructure, airports performed strongly as many returned to paying dividends. Within Utilities, rising construction and debt funding costs negatively impacted utilities. An area that has been particularly 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 U.S. energy market, greater capital discipline in recent times, stronger balance sheets of late, and potential upside—though arguably not as great as that of the producers—should energy prices stay higher for longer. **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, and will rely heavily on debt and equity funding conditions to fund their significant capex projects . We see an uncertain road ahead for utilities as companies balance up their renewable energy 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. The transition to full renewable energy electricity generation is likely to be a long path due to different needs of various stakeholders.
• U.S. Energy Infra & MLPs	Medium	

Asset Class	Conviction	Rationale
Listed Property		**Backdrop** Global real estate investment trusts (GREITs) were positive performers, up low double-digits for the year, and were boosted by strong returns in the last quarter of 2023 when bond yields fell. The real estate asset class made plenty of headlines during the year, mostly tied to office assets in urban centers that have been underperforming due to working from home (WFH) being a persistent trend, tenant bankruptcies, and/or debt funding concerns. But it’s important to remember, real estate is a large category and office assets represent only a small slice of a much larger pie. GREITs had been an underweight across our portfolios for several years, but it’s possible negative sentiment—and associated price declines—could create an opportunity to increase exposure. **Outlook** REITs continue to remain dually exposed to economic conditions—both from a top-line rental growth perspective and also from 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. 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. While debt funding costs fell in late 2023, elevated risks remain present as debt funding remains unavailable to REITs experiencing high leverage levels and/or rental pressure, increasing the chances of dilutive and discounted equity raisings taking place.
• U.S. REITs	Medium	
• Global REITs	Medium	

Alternatives
Alternatives offered a strong ballast last year, though the impact was less pronounced in a year with strong equity returns. 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 U.S. 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.

Since its original publication, this piece may have been edited to reflect the regulatory requirements of regions outside of the country it was originally published in.

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