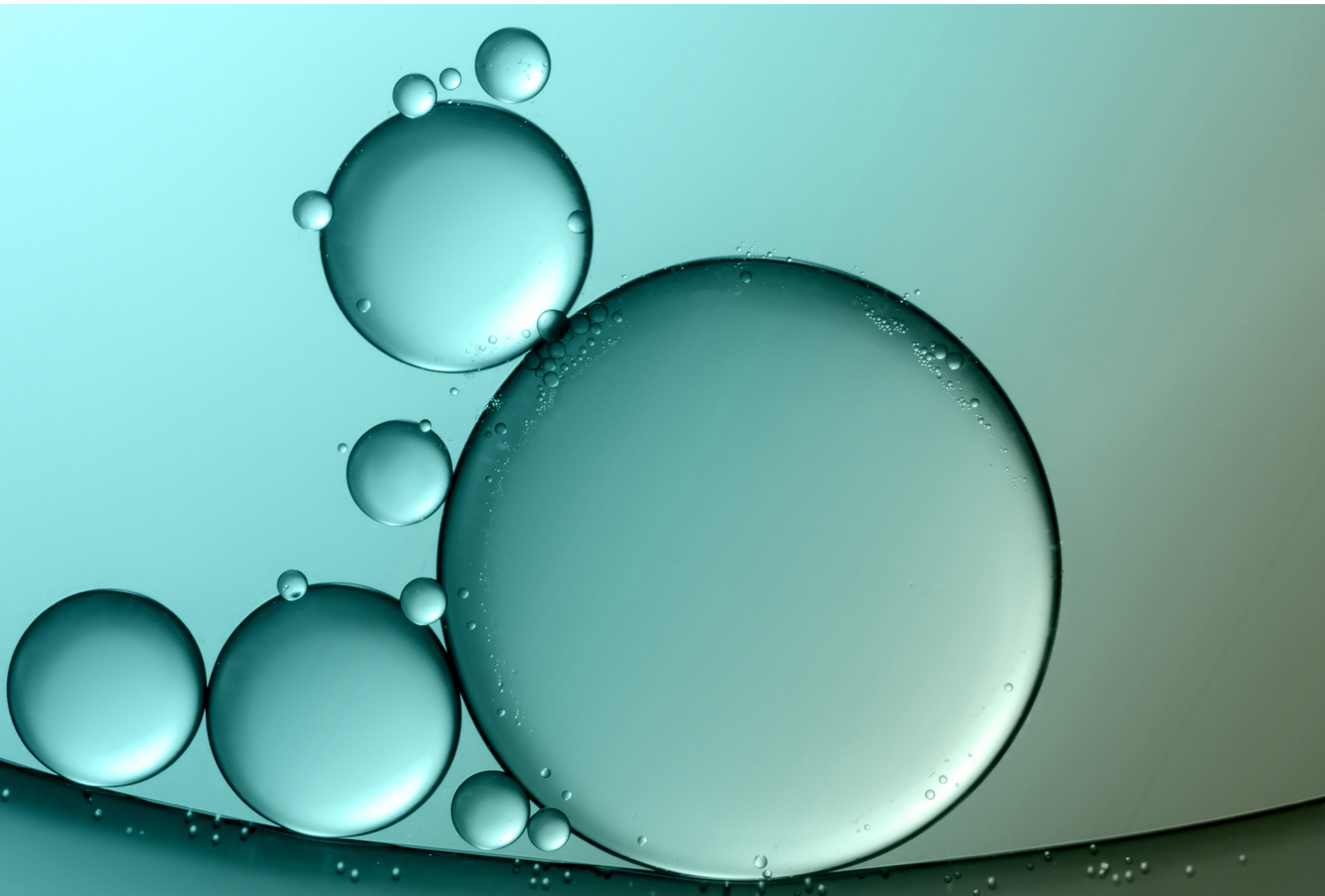

NEUBERGER BERMAN

Asset Allocation Committee Outlook 1Q19

Fundamental Laws

The proportion of asset classes that ended 2018 in the red was unprecedented, driven by two structural transitions: from quantitative easing to quantitative tightening, and from a globally synchronized to a multi-cycle growth dynamic. In 2019, we expect the Federal Reserve to ease the U.S. into a "soft landing" and believe China's renewed stimulus could support recovery in the rest of the world. We still expect QE to become QT and political risks to persist, but we think this global re-convergence can lead to market outcomes that are more positive—and more diverse—than last year's.

NEUBERGER | BERMAN

ABOUT THE

ASSET ALLOCATION COMMITTEE

Neuberger Berman's Asset Allocation Committee meets every quarter to poll its members on their outlook for the next 12 months on each of the asset classes noted and, through debate and discussion, to refine our market outlook. The panel covers the gamut of investments and markets, bringing together diverse industry knowledge, with an average of 27 years of experience.

COMMITTEE MEMBERS

Joseph V. Amato
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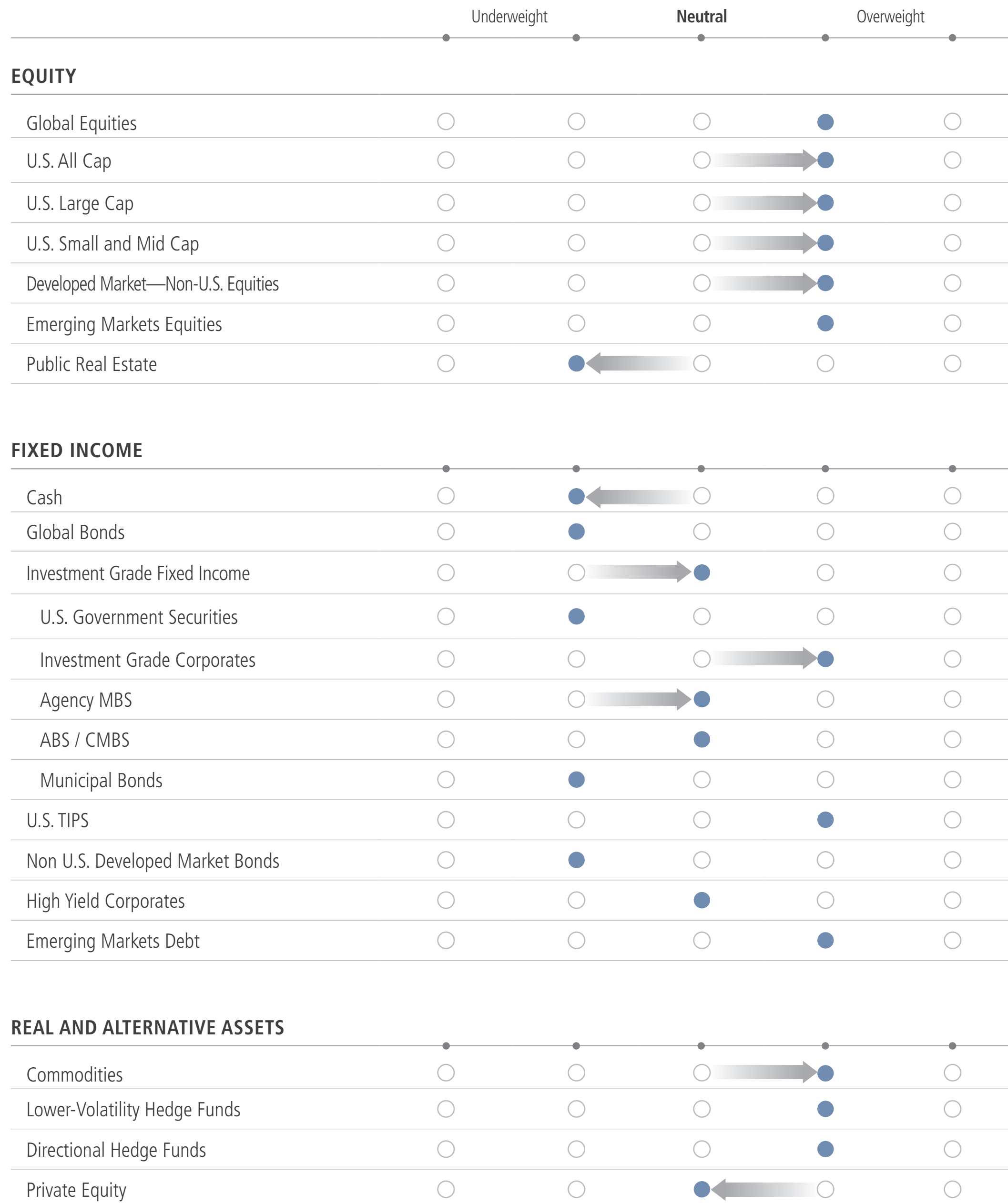
Ugo Lancioni
Head of Global Currency

Brad Tank
Chief Investment Officer—Fixed Income

Anthony D. Tutrone
Global Head of Alternatives

Market Views

Based on 12-Month Outlook for Each Asset Class



As of 1Q 2019. Views shown reflect near-term tactical asset allocation views and are based on a hypothetical reference portfolio. Nothing herein constitutes a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. See disclosures at the end of this publication, which include additional information regarding the Asset Allocation Committee and the views expressed.

Regional Focus

Fixed Income, Equities and Currency

> "WE EXPECT U.S. GROWTH TO MODERATE, RELATIVE TO THE REST OF THE WORLD. NON-U.S. ECONOMIES, BOTH DEVELOPED AND EMERGING, TOOK THEIR HIT IN 2018, AND THE BASELINE SCENARIO FOR 2019 IS MORE STABILITY AT THESE LOWER LEVELS OF GROWTH."

Ashok Bhatia, CFA | Deputy Chief Investment Officer—Fixed Income

As of 1Q 2019. Views shown reflect near-term tactical asset allocation views and are based on a hypothetical reference portfolio. Nothing herein constitutes a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. See disclosures at the end of this publication, which include additional information regarding the Asset Allocation Committee and the views expressed.

"THE END OF 2018 WAS ALMOST A PERFECT MIRROR IMAGE OF THE END OF 2017. THE FUNDAMENTALS OF MEAN REVERSION WOULD SUGGEST THAT 2019 IS LIKELY TO PITCH ITSELF SOMEWHERE BETWEEN THESE TWO EXTREMES, EVEN IF THE AAC'S FUNDAMENTAL ECONOMIC AND MARKET VIEWS DID NOT FULLY SUPPORT THE SAME THESIS."

Erik L. Knutzen, CFA, CAIA
Chief Investment Officer—Multi-Asset Class

Fundamental Laws

Stock markets sold off in the fourth quarter, capping a volatile year. The declines in equities were only part of the negative story. The proportion of asset classes that ended 2018 in the red was unprecedented as major global stock, bond, currency, commodities and even hedge fund averages lost money. This challenging situation was driven by two structural transitions: from quantitative easing to quantitative tightening, and from a globally synchronized to a multi-cycle growth dynamic. In 2019, we believe the global economy will reconnect and resume a more balanced posture as the Federal Reserve pauses rate hikes and allows the U.S. to ease into a "soft landing," and China's renewed stimulus supports recovery in the rest of the world. We still expect central banks to shrink their balance sheets and political risks to persist, but this restoration of sustainable global growth, together with simple mean reversion, would likely give us market outcomes that are more positive—and more diverse—than last year's.

When the Asset Allocation Committee ("AAC" or "the Committee") met this time last year, we were talking about 2018 being "a game of two halves." We sensed that the prevailing environment, characterized by synchronized global growth, historically low financial market volatility and positive calendar-year returns for almost every asset class, could not last. In the event, volatility jumped in February, emerging markets endured a severe summer sell-off, and economic activity outside the U.S., especially in Europe, slowed earlier and more persistently than expected.

However, it was during the fourth quarter that self-doubt really took hold in the markets. Equities sold off again, credit markets went with them, oil slid into a bear market, U.S. Treasury yields retreated and almost inverted the curve, and the put-to-call option ratio hit bearish levels not seen since 2008. As the table on the next page indicates, almost no form of long-term investment was compensated during 2018—a worse result even than in 2008.

Such a structural outcome in markets is likely to have structural origins. We think investors are struggling to navigate two transitions within the current business cycle: from quantitative easing to quantitative tightening, and from globally synchronized growth to a multi-cycle dynamic in which the U.S. has been pulling away from the rest of the world. As we entered the fourth quarter of 2018, the AAC acknowledged that we were at a "critical point" in the cycle.

MARKETS IN THE RED, 2008–2018

Calendar Year Total Return for 17 Asset Classes

2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
10-Year UST	MSCI EM	REITS	10-Year UST	MSCI China	Russell 2000	REITS	MSCI Japan	Commodities	MSCI China	2-Year UST
2-Year UST	MSCI China	Russell 2000	Inflation Bonds	MSCI Europe	S&P 500	S&P 500	REITS	Russell 2000	MSCI EM	U.S. HY
U.S. Agg Bond	Global HY	Commodities	EM HC Sov	Global HY	MSCI Japan	10-Year UST	10-Year UST	U.S. HY	MSCI Europe	U.S. Agg Bond
EM LC Debt	U.S. HY	MSCI EM	U.S. IG	REITS	MSCI Europe	MSCI China	EM HC Sov	Global HY	MSCI Japan	10-Year UST
U.S. IG	Commodities	MSCI Japan	U.S. Agg Bond	MSCI EM	U.S. HY	U.S. IG	S&P 500	S&P 500	S&P 500	REITS
Inflation Bonds	MSCI Europe	U.S. HY	REITS	EM HC Sov	Global HY	EM HC Sov	2-Year UST	MSCI EM	Russell 2000	U.S. IG
EM HC Sov	EM HC Sov	S&P 500	U.S. HY	Russell 2000	MSCI China	U.S. Agg Bond	U.S. Agg Bond	EM HC Sov	EM LC Debt	S&P 500
U.S. HY	REITS	Global HY	Global HY	S&P 500	REITS	Russell 2000	U.S. IG	REITS	Global HY	Global HY
Global HY	Russell 2000	EM LC Debt	S&P 500	U.S. HY	2-Year UST	Inflation Bonds	MSCI Europe	U.S. IG	EM HC Sov	Inflation Bonds
Commodities	S&P 500	EM HC Sov	2-Year UST	EM LC Debt	U.S. IG	U.S. HY	Global HY	EM LC Debt	REITS	EM HC Sov
MSCI Japan	U.S. IG	10-Year UST	EM LC Debt	U.S. IG	U.S. Agg Bond	2-Year UST	Russell 2000	Inflation Bonds	Inflation Bonds	EM LC Debt
Russell 2000	EM LC Debt	U.S. IG	Russell 2000	Inflation Bonds	MSCI EM	Global HY	U.S. HY	MSCI Japan	Commodities	Commodities
S&P 500	Inflation Bonds	U.S. Agg Bond	Commodities	MSCI Japan	Inflation Bonds	MSCI EM	Inflation Bonds	U.S. Agg Bond	U.S. HY	Russell 2000
REITS	MSCI Japan	MSCI China	MSCI Europe	U.S. Agg Bond	EM LC Debt	EM LC Debt	MSCI China	MSCI China	U.S. IG	MSCI Japan
MSCI Europe	U.S. Agg Bond	MSCI Europe	MSCI Japan	10-Year UST	10-Year UST	MSCI Japan	EM LC Debt	2-Year UST	U.S. Agg Bond	MSCI Europe
MSCI China	2-Year UST	Inflation Bonds	MSCI EM	Commodities	EM HC Sov	MSCI Europe	MSCI EM	10-Year UST	10-Year UST	MSCI EM
MSCI EM	10-Year UST	2-Year UST	MSCI China	2-Year UST	Commodities	Commodities	Commodities	MSCI Europe	2-Year UST	MSCI China

Source: Bloomberg. Data as of December 30, 2018. Markets are ranked top to bottom on calendar-year total return.

Three eventful months later, do we share the market's lack of confidence?

No, we do not. We have reaffirmed our bias toward global stocks, increasing our exposure to developed markets equities, as well as other markets with higher risk-adjusted return outlooks, such as emerging markets, segments of credit, and commodities. This reflects the twin pillars for our core outlook: we still expect QE to become QT, but especially after its rate hike in December, we expect the Federal Reserve to pause, facilitating a "soft landing" for the U.S. in 2019; and we believe that the market underestimates the ability of China to successfully stabilize its growth trajectory, and with it the rest of the world.

If we are right, the net result could be a re-synchronization of global growth at more sustainable levels, and some mean reversion in the pricing of financial markets.

A Soft Landing for the U.S.

The Committee members see little risk to the Fed's balance sheet policy—or the European Central Bank's (ECB), for that matter. Treasury yields are in check as increased supply is being met by robust real-money demand, and in the event of a growth disappointment there are rates-related levers to pull before QT is abandoned.

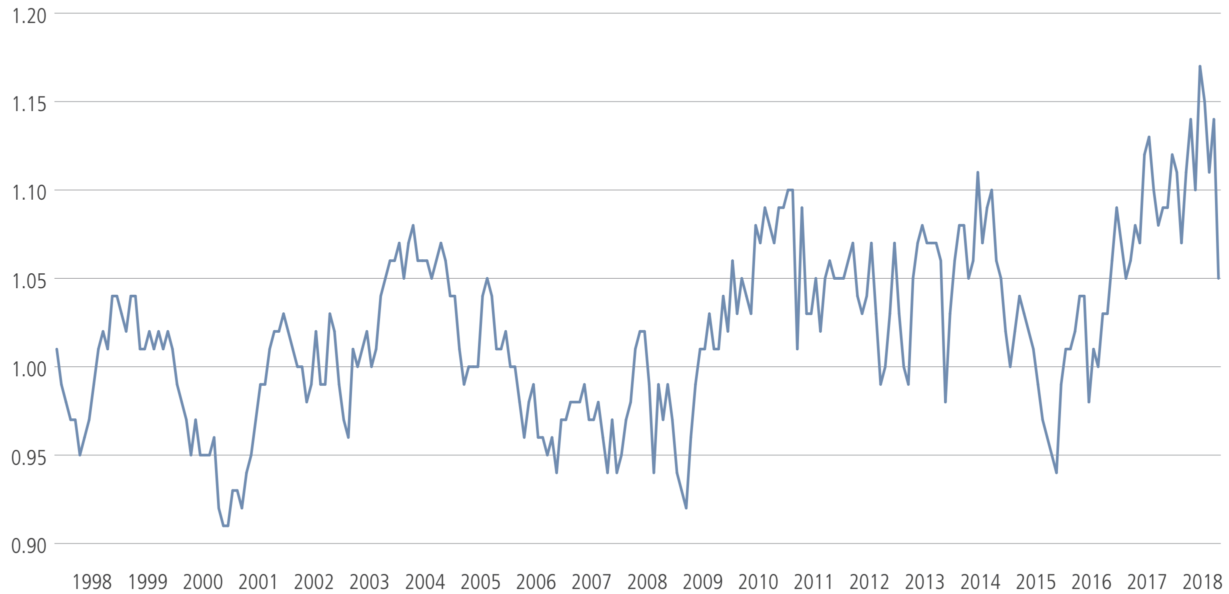
We do think the Fed will now pause for at least the first half of 2019, potentially introducing one or two more rate hikes later in the year. Wage inflation is ticking up, but not feeding into broader headline inflation. Lower oil prices are also helping to ease that pressure. The Fed has also made clear its willingness to tolerate slightly higher-than-target inflation.

At the end of 2018, markets abruptly shifted to pricing for a marked slowdown in the U.S. economy. We remain more confident in the central bank's ability to prepare a soft landing.

Our forecast is for U.S. GDP growth to slow from around 3% in 2018 to 2.0–2.5% in 2019. That would represent a return to post-crisis trend growth, which is what the rest of the world experienced last year. It is therefore a more sustainable level of growth which, together with the Fed pause, could extend the cycle well into 2020. It suggests substantially lower earnings growth for U.S. equity investors as tax cuts fade and wages

U.S. ECONOMIC ACTIVITY PULLED AWAY FROM THE REST OF THE WORLD'S DURING 2016–2018

Ratio: U.S. ISM/Global PMI



Source: FactSet, Neuberger Berman. Data as of December 31, 2018.

rise, but leaves an increased possibility of multiple expansion—especially after valuations fell to below their historical average toward the end of 2018.

China Could Stimulate the Rest of the World

Outside the U.S., economic activity started slowing a year ago; as a result, China, in particular, has adopted stimulus policies again. A lack of domestic demand and the background trade tensions with the U.S. could still prevent that stimulus from gaining traction, but our central scenario sees China's slowdown stabilizing this year.

This would likely improve business sentiment and activity in the developed economies outside the U.S., supported by lower energy costs. We anticipate only a gradual recovery in oil prices, as production from U.S. shale producers partly offsets OPEC supply cuts. While Q3 2018 data out of Japan and Germany was weak, this was largely due to a collapse in diesel auto sales in Germany, and a combination of catastrophic floods and preparations for the forthcoming consumption-tax hike in Japan, all of which are likely to fall out of next quarter's data. In addition, both the Bank of Japan and the ECB look set to remain accommodative.

Political risk remains quite pronounced in Europe, and therefore, on balance, the Committee has a bias toward Japan and emerging markets in its positive view on non-U.S. regions, at least in the short term, while we await clarity on these risks. (See "Up for Debate: Where is political and policy risk most likely to blow up in 2019?")

Adding Risk…

After the signficiant sell-off in the fourth quarter of 2018, the Committee has upgraded equities in the U.S., seeing outsized opportunities in developing countries.

A tilt in favor of emerging markets and commodities could be interpreted as a very confident, "risk-on" or "high-beta" view.

That is not really the case, however. While some Committee members felt that a positive view on cyclical and trade-oriented markets should imply a similarly favorable outlook for cyclical and value stocks in the U.S., overall, as in credit, the AAC believes that a preference for value over growth should be married with a focus on quality, which will become increasingly important.

Moreover, the AAC's favorable view of stocks outside the U.S. and commodities says more about their potential for mean reversion—emerging markets sold off hard last summer and oil prices collapsed in the fourth quarter.

"Bottoming out is not a one-day event," as one Committee member put it. "It might be counterintuitive, but I think it started in October, because that's when emerging markets bounced. The outperformance of emerging market debt, currencies and equities through the volatility of the fourth quarter ought to build confidence."

…Cautiously

While the AAC expects pessimism to lift from markets and global growth to re-synchronize to some extent, the underlying reality of mature-cycle volatility and relatively tight correlations is likely here to stay. Persistent tail risks include political events, trade tensions, signs of disinflation, and the fact that anxiety can periodically spike simply because "slow growth" can sometimes feel like "no growth." The Committee favors adding risk, but cautiously.

Helpfully, credit spreads have widened enough to make corporate bonds viable for the first time in a while. The broad U.S. high yield market is yielding more than 7%. As such, while the AAC still prefers global equities over global bonds and regards developed market government bond yields outside the U.S. as too low, we have upgraded our views across the credit sectors.

We still consider this opportunity to be particularly attractive at the short and intermediate end of the credit curve, and would describe it as favoring higher-quality issuers in high yield, alongside some of the more attractively priced investment grade names. A portfolio built in this way could reach a 5–6% yield profile, which would be attractive in a slowing-growth environment beset by event risk.

For the same reasons of high volatility and stock-bond correlation, the Committee remains favorable toward hedge funds. Many failed to capitalize on the conditions set up last year, often being wrong-footed by whipsawing in trades that had been strongly trending, such as value stocks versus momentum stocks, and certain parts of commodity futures curves. Nonetheless, we believe the fundamental background is still supportive. Private markets were downgraded to neutral to reflect the high valuations and overstretched leverage in many traditional buyout deals, but the Committee still sees opportunity available in the broader sector. (See "Up for Debate: Are private markets overstretched?")

Back into Balance

The end of 2018 was almost a perfect mirror image of the end of 2017. A year of synchronized global growth gave way to a year of surprisingly persistent growth divergence. A year in which seemingly all financial assets went up gave way to a year in which an unprecedented number went down. A year of historically low market volatility gave way to a rollercoaster ride.

The fundamentals of mean reversion would suggest that 2019 is likely to pitch itself somewhere between these two extremes, even if the AAC's fundamental economic and market views did not fully support the same thesis. As it stands, we anticipate a soft landing in the U.S. and a moderate recovery elsewhere, extending this record-breaking cycle through the end of the year, and supporting a positive, but still volatile environment for risk assets.

UP FOR DEBATE
WHERE IS POLITICAL AND POLICY RISK MOST LIKELY TO BLOW UP IN 2019?

Investors have had to deal with heightened policy risk since at least the financial crisis, which was met with unprecedented fiscal and monetary stimulus efforts, and with heightened political risk in the years since Brexit, as a new wave of populism has gripped countries in both the emerging and developed worlds.

In 2018, the focal points for these risks were arguably Latin America, which held a string of elections, the U.S. and China, whose trade dispute worsened significantly, and the Federal Reserve, which appointed a new Chair.

With the Democratic Party taking control of the House of Representatives again in November, many members of the Asset Allocation Committee ("AAC" or "the Committee") anticipate continued political risk in the U.S. Alongside the completion of the Special Counsel's investigation into President Trump's election campaign, it is now possible for his political adversaries to sponsor further enquiries—all at a time when the White House's support from Congressional Republicans and the business lobby could be melting away. The recent government shutdown may be a harbinger of what is to come.

While both sides have clear incentives to reach some kind of understanding, a deterioration in the U.S. – China trade dispute remains possible all the time that the underlying issues remain unresolved—and resolution will require deep, long-term reform. That would be disruptive for all markets.

Overall, however, the Committee believes that this is likely to create a lot of noise to distract markets without causing a substantial hit to the economic outlook. The more important political and policy risks may be located elsewhere.

Perhaps the most likely location of a political or policy blow-up in 2019 is Europe. We are witnessing the end of the Merkel era in Germany and the Draghi era at the European Central Bank (ECB). Brexit is due at the end of March. Governing populists in eastern Member States will likely go on causing headaches for the European Union, and their ideological brethren look set to get a boost in elections to the European Parliament in May. Italy's populist government, in power since last spring, ended 2018 with a compromise budget agreement with the European Commission—but implementation over the next 12 months remains a risk. In the meantime, President Emmanuel Macron of France, the great hope for liberalism and globalism in the post-Merkel era, ended 2018 stretching EU budget rules to quell a nationwide wave of civil unrest.

This need not be bad for European risk assets. Some of these risks are priced in, and avoidance of the worst outcomes could lead to a strong recovery in markets in the event of our central scenario of a recovery in Europe's economic data. A little anti-austerity spending, especially from Germany, could even combine with recovering business activity and rising wages to give the continent a boost and alleviate some of its imbalances.

We remain cautious on Europe in the short term, therefore, while we await some clarity on the political trends. In the meantime, the Committee thinks that exposure to the broad theme of a re-convergence of the U.S. and the rest of the world can be equally well implemented through Japanese and emerging market assets as through Europe, with potentially mitigated short-term political and policy risk.

UP FOR DEBATE
ARE PRIVATE MARKETS OVERSTRETCHED?

Amid a general willingness to accept risk exposure in its views, the Asset Allocation Committee ("AAC" or "the Committee") decided to change its outlook for private equity from positive to neutral. We have remarked on the high valuations and aggressive capital structures in the buyout sector for some time. Is this the quarter when the Committee finally concluded that private markets are overstretched?

That would overstate what was a complex debate.

AAC members who are closest to private markets reiterated concern over valuations and leverage in some parts of the buyout sector. Given these high valuations, they argued that a significant number of deals depend heavily on aggressive operating improvements or roll-up acquisition strategies to generate attractive returns—clearly increasing risk.

On the other hand, they still believed a broadly diversified, strategic and consistent approach to private equity could continue to earn an appropriate premium over the public markets.

A steady program of commitments, which typically take three to five years to put to work in investments, can help smooth vintage effects through the cycle, they argued. By being selective in the buyout sector, as well as willing to look beyond buyout for opportunity, they believe investors can mitigate valuation and leverage risks without giving up too much upside potential. They suggested focusing on private equity firms that have emphasized quality in their acquisitions, and proven their expertise at growing portfolio companies' earnings through strategic operational-improvement plans.

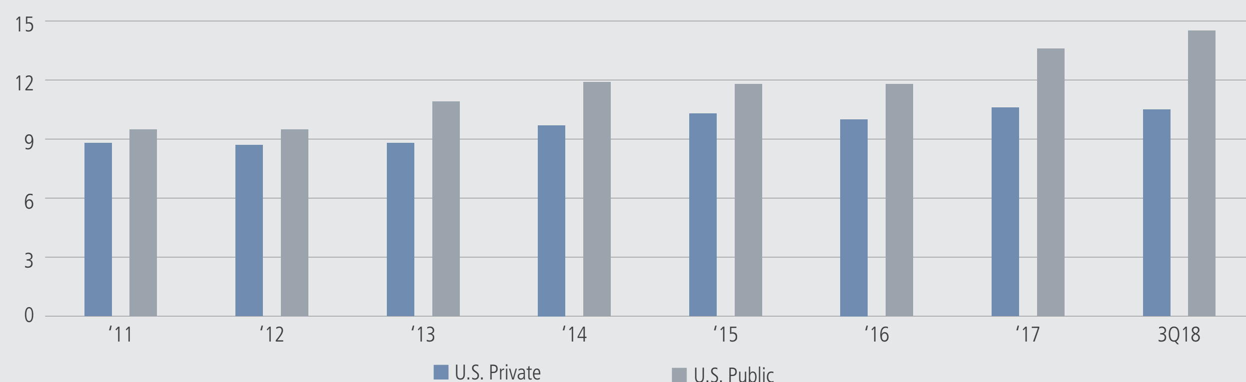
Away from traditional buyouts, there are interesting niche private market strategies that could mitigate risks related to the current exuberance while still offering attractive risk-adjusted return potential. These tend to focus on less competitive and complex situations and often use structuring to provide additional protections and mitigate risk, such as seniority in the capital structure, shorter duration or current cash yields.

In private debt, given the current, aggressive capital structures, Committee members are biased toward first lien over second lien and prefer less cyclical companies with strong cash flows. Some reported that they have started to see some proposed private debt and leveraged loan deals involving riskier capital structures and weaker businesses being pulled from the market—deals that would have been completed six months ago. Together with the large amount of BBB credit at risk of a downgrade, the refinancing problems that many companies could face potentially lines up an opportunity for opportunistic and distressed debt strategies in 2019, particularly those operating in the semi-liquid parts of those markets.

The AAC decided that it was prudent to take a neutral view on private equity, then, but it also believes that the broader private markets remain a source of attractive opportunity for those who place a premium on proven and experienced managers, attractive niche strategies, flexibility—and possibly distressed debt.

PRIVATE MARKET MULTIPLES HAVE RISEN, BUT STILL NOT AS FAR AS PUBLIC MARKET MULTIPLES

U.S. private versus public equity valuations (EV/LTM EBITDA)



Source: S&P Capital IQ LCD. Data as of September 30, 2018.

FIXED INCOME

Investment Grade Fixed Income

The Asset Allocation Committee ("AAC" or "the Committee") remains underweight government securities, but has upgraded its view on some parts of investment grade credit and securitized products. Markets have priced in fewer rate hikes in 2019 than in prior months. The Fed has noted that interest rates are close to the neutral rate and in December it revised its language to signal fewer hikes given slower economic growth. It has reiterated that policy will depend on economic data. Both the Fed and the European Central Bank (ECB) are expected to maintain their balance sheet reduction policies. Credit selection has become more important as spreads have widened.

U.S. TIPS

The Committee maintained its overweight view. Breakeven inflation rates fell toward the end of 2018, but wages continue to rise and there is still upside potential in consumer prices, particularly if trade conflict puts pressure on input costs.

Developed Market Non-U.S. Debt

The Committee maintained an underweight view, as the ECB and Bank of Japan (BoJ) are still lagging the U.S. in tightening policy.

Emerging Markets Debt

The Committee maintained an overweight view. There has been no big change in emerging markets fundamentals since last quarter, but valuations remain attractive after the sell-off in summer 2018.

High Yield Fixed Income

The Committee voted to maintain a neutral view. As credit spreads widen, a focus on higher quality companies becomes increasingly important. Bonds, especially at short duration, are favored over bank loans, particularly now that the likelihood of an earlier-than-expected pause to the Fed hiking cycle has risen.

EQUITY

U.S. Equities

The Committee moved to an overweight view for U.S. Large Cap and U.S. Small & Mid Cap. As the impact of U.S. fiscal stimulus wanes, U.S. growth is expected to converge with developed non-U.S. and emerging market growth. U.S. earnings growth is expected to be in the single digits next year, down from mid-20% growth in 2018. The Committee has a preference for value over growth but, as in credit, a focus on quality will be increasingly important. Geopolitical risks remain elevated due to trade frictions with China. Nonetheless, the sell-off in the last quarter of 2018 was strong enough to leave U.S. equity valuations trading near the lows of their historical range, creating potential for multiple expansion this year.

Public Real Estate

The Committee voted to downgrade public real estate to an underweight view. This sector has outperformed during the volatility of recent months, but if rate hikes pause and U.S. growth experiences the "soft landing" that is our central scenario, investors may begin to rotate out of defensive, income-generating equity sectors, which would include REITs.

Non-U.S. Developed Market Equities

The Committee moved from a neutral outlook on Developed Non-U.S Equities to overweight. In Europe, despite a slowdown in 2018, growth is still at or above trend. While there are signs of a pick-up in wage growth, there are few signs of consumer price inflation, which allows the ECB to remain accommodative even as it starts to reduce its balance sheet; it has said that it does not intend to raise interest rates until the summer. Nonetheless, we remain cautious in the short term as there are significant political risks, including Brexit, Italy's budget compromise and the potential for populist parties to perform strongly in May's elections to the European Parliament. Japanese equities are likely to benefit from the weak yen, and while the forthcoming consumption tax increase has suppressed recent growth, the government is ready to provide fiscal stimulus to offset the impact, and the BoJ remains committed to its yield targeting policy for now.

Emerging Markets Equities

The Committee maintained its overweight view. Fiscal and monetary easing in China are in the pipeline to counteract a slowdown and the impact of trade tensions. The AAC's longer-term outlook remains positive despite short-term volatility and negative sentiment related to the trade risks. The AAC believes that the sell-off in 2018 has left attractive valuations, even after the recent modest recovery—although trade tensions, a strong dollar and China's managed slowdown remain key risks.

REAL AND ALTERNATIVE ASSETS

Commodities

The Committee voted to upgrade to an overweight view in commodities, as OPEC agreed to cut oil production by 1.2 mbd to reduce the global oil glut—while recognizing the risk posed by short-term supply uncertainties, continuing U.S. production and downside risks in the global economy. The ongoing depletion of industrial metals inventories indicates that risk aversion around trade tensions may be to blame for poor recent performance rather than a fundamental lack of demand. Easing of these tensions could support these markets, as well as key agricultural commodities. A weaker dollar may also provide a tailwind.

Hedge Funds

The Committee maintained its overweight view in both lower-volatility and directional strategies—albeit with a cautious eye on directional strategies in equities and commodities as market volatility increases. Correlations between stocks and bonds have tended to reach highs toward the end of the business cycle, while dispersion within markets has tended to increase. Many hedge funds failed to take advantage of these conditions later in 2018, but the AAC maintains an overall positive view.

Private Equity

The Committee downgraded its view from overweight to neutral. Buyout valuations are extended, leaving a lower probability of multiple expansion. It is for this reason that the worst vintage years have historically been two to three years before the peak in public markets, meaning that the timing is not optimal if the cycle is forecast to turn in 2020 or 2021, as seems likely. Nonetheless, the Committee believes private equity is still attractive relative to public equities, particularly with a focus on higher quality businesses in buyout and a broad strategy that takes opportunity in more niche sectors and private debt markets.

Currencies

USD: The Committee downgraded USD to a slight underweight. Market participants are positioned long despite overvaluation on PPP metrics, Fed tightening being largely priced in, a twin deficit, stabilizing inflation and the prospect of a U.S. slowdown in 2019. Risks to the view are that the growth gap versus the rest of the world is still large, leading to supportive short-term yield differentials, and that the USD will be seen as a safe haven if there is any reason for risk aversion in 2019.

EUR: The Committee moved to neutral on the EUR. Despite a slowdown in 2018, growth is still at or above trend and the euro zone is running a large current account surplus. Risks to the view include accommodative ECB policy in the face of weak inflation, and political risks that include the Italian budget negotiations and the threat of tariffs in the auto sector.

JPY: The Committee downgraded JPY to neutral. JPY is undervalued on a PPP basis and tends to be a safe haven during risk aversion. Moreover, the recent growth deceleration is expected to reverse, the current account is in surplus, and the BoJ has signaled a willingness to reconsider its yield curve-targeting policy. However, the currency is burdened by unfavorable yield differentials and could be vulnerable to outflows if the AAC's central scenario of a rebalancing of the global economy in 2019 is realized.

GBP: The Committee maintained its slight overweight. GBP is undervalued based on PPP measures, offering a potentially attractive Brexit premium. U.K. job creation and wage growth have been stronger than expected and a recent Bank of England rate hike has pushed yield differentials in favor of the currency. Risks to the view include the high uncertainty around Brexit, as well as continued weakness in the U.K.'s trade balance and manufacturing data.

CHF: The AAC maintained its heavily underweight view. The franc is still overvalued based on PPP measures, and that is keeping inflation low. It is one of the most attractive funding currencies, and the Swiss National Bank will likely lean against any rapid appreciation. Risks to the view include political uncertainty causing more haven demand, Switzerland's strong current account balance, a potential uptick in the country's inflation dynamics and the anticipated wider European growth recovery. Difficulties with Switzerland's trade deal with the EU also bear watching.

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