NEUBERGER BERMAN

Asset Allocation Committee Outlook 4Q18

A Critical Point in the Cycle

Going into the fourth quarter, the Asset Allocation Committee (AAC, "the Committee") reflects upon how unusual 2018 has been for financial markets. One of its most notable features has been some extreme divergences between asset classes that have usually exhibited high correlation. At the latest AAC meeting, debate focused on whether these are significant relative value opportunities. If the business cycle can extend through 2019 and becomes the longest of the modern age, they probably are. But does recent volatility suggest they might really be a sign of how brittle that cycle has become?

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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 25 years of experience.

COMMITTEE MEMBERS

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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

	Underweight		**Neutral**	Overweight	
EQUITY					
Global Equities	○	○	○	●	○
U.S. All Cap	○	○	●	○	○
U.S. Large Cap	○	○	●	○	○
U.S. Small and Mid Cap	○	○	●	○	○
Developed Market—Non-U.S. Equities	○	○	●	○	○
Emerging Markets Equities	○	○	○	●	○
Public Real Estate	○	○	●	○	○
FIXED INCOME					
Cash	○	○	●	○	○
Global Bonds	○	●	○	○	○
Investment Grade Fixed Income	○	●	○	○	○
U.S. Government Securities	○	●	○	○	○
Investment Grade Corporates	○	●	○	○	○
Agency MBS	○	●	○	○	○
ABS / CMBS	○	○	●	○	○
Municipal Bonds	○	●	○	○	○
U.S. TIPS	○	○	○	●	○
High Yield Corporates	○	○	●	○	○
Emerging Markets Debt	○	○	○	●	○
REAL AND ALTERNATIVE ASSETS					
Commodities	○	○	●	○	○
Lower-Volatility Hedge Funds	○	○	○	●	○
Directional Hedge Funds	○	○	○	●	○
Private Equity	○	○	○	●	○

As of 4Q 2018. 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 presentation for additional information regarding the Asset Allocation Committee and the views expressed.

Regional Focus

Fixed Income, Equities and Currency

> "Twelve months from now I can see China easing. Sentiment could be a headwind and there could be a leg down in trade and economic data, but market has a lot of that priced in and the valuations are attractive now."
>
> AJAY JAIN, HEAD OF MULTI-ASSET CLASS PORTFOLIO MANAGEMENT

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

A Critical Point in the Cycle

Going into the fourth quarter, the Asset Allocation Committee (AAC, "the Committee") reflects upon how unusual 2018 has been for financial markets. One of its most notable features has been some extreme divergences between asset classes that have usually exhibited high correlation. Consider the huge performance gaps between U.S. and emerging markets, for example, or between growth and value stocks. At the latest AAC meeting, debate focused on whether these are significant relative value opportunities. If the business cycle can extend through 2019 and becomes the longest of the modern age, they probably are. But does recent volatility suggest they might really be a sign of how brittle that cycle has become?

By the end of August 2018, the S&P 500 Index was up 9.94% for the year while the MSCI Emerging Markets Index was down 6.99%—a difference of almost 17 percentage points. Within the U.S., the Russell 1000 Growth Index had outperformed the Russell 1000 Value Index by 12.73 percentage points. Similar divergences have opened up within most asset classes. U.S. high yield was up 2% by the end of August, for example, but emerging markets local currency bonds, whose issuers enjoy a better average credit rating, were down 10.47%.

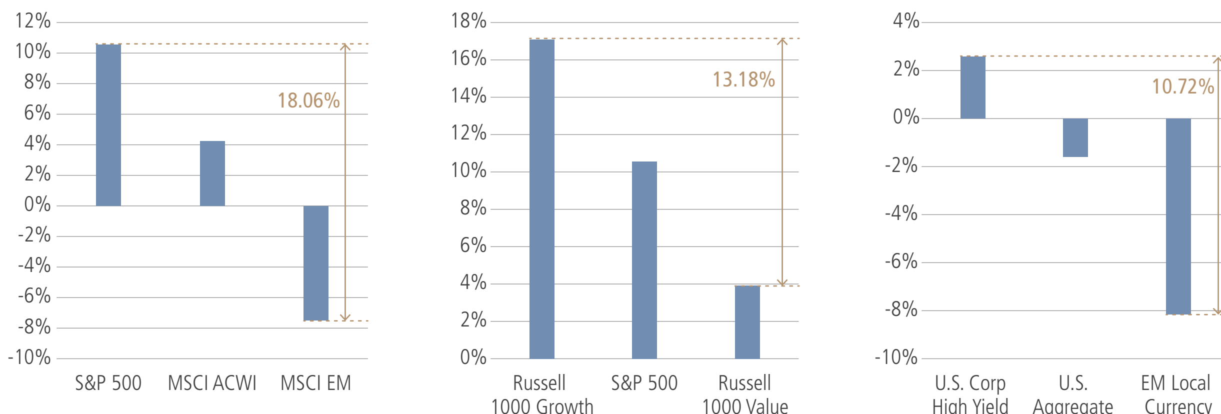
While notable, these divergences can be explained by underlying fundamentals. Economic data out of the U.S. has been robust. Similar data out of Europe and the emerging world has softened. That and the boost to U.S. business from domestic tax policy have fuelled expectations for higher U.S. interest rates and a stronger dollar. A strong dollar raises concerns about emerging markets, as does the discordant mood music on global trade. And when it comes to value versus growth, while value stocks have tended to outperform late in the cycle, this is an unusual late-cycle environment: low growth, low inflation and subdued business confidence at the global level has sustained demand for U.S. growth stocks.

Divergences like these could be significant relative value opportunities. In the AAC's central scenario, in which U.S. data moderates and the rest of the world stabilizes, these markets are likely to re-converge to the mean. The business cycle could then extend to become the longest on record.

There are risks, however. Some of these relate to short-term shocks that could result in another leg wider in these divergences: a market-unfriendly election result in Brazil, further heated debate within the European Union over the sustainability of Italy's budget, a surprise result in the U.S. mid-terms, a hard Brexit. These would likely delay but not derail market convergence.

MARKET DIVERGENCE—BETWEEN REGIONS, WITHIN REGIONS, ACROSS ASSET CLASSES

Market performance year-to-date as of September 28, 2018



Source: Bloomberg. For illustrative purposes only. Investing entails risks, including possible loss of principal. Indexes are unmanaged and are not available for direct investment. **Past performance is not indicative of future results.**

A more profound, fatal blow could be struck to the business cycle should we see a continuation of the economic dynamics that caused this year's market divergences. Stresses and strains such as these appear to be behind the most recent bout of volatility to strike bond and equity markets. A world in which the U.S. continues to power forward in isolation is one in which the Federal Reserve is forced to move aggressively before the European Central Bank (ECB) or the Bank of Japan (BoJ) are ready to normalize their own policies. In that world, the dollar could soar, which would likely cause financial conditions to tighten sharply and crush the cycle.

A Closer Look at Emerging Markets

Emerging markets would likely fare worst in those conditions, and this year's sell-off across debt, equities and local currencies had the feel of late-cycle tremors. For that reason, they were the focus of the Committee's discussions, and where we tested our core views most rigorously.

The AAC suspects that emerging markets are pricing dollar and U.S. interest rate risk cautiously, because the perceived links are a widely accepted consensus. In fact, among bearish periods in emerging markets since the 1980s, only the 1982 Latin American crisis and the 1994 Mexican "Tequila Crisis" were connected to rising U.S. rates. On the four other occasions when the Fed was hiking, emerging markets rallied.

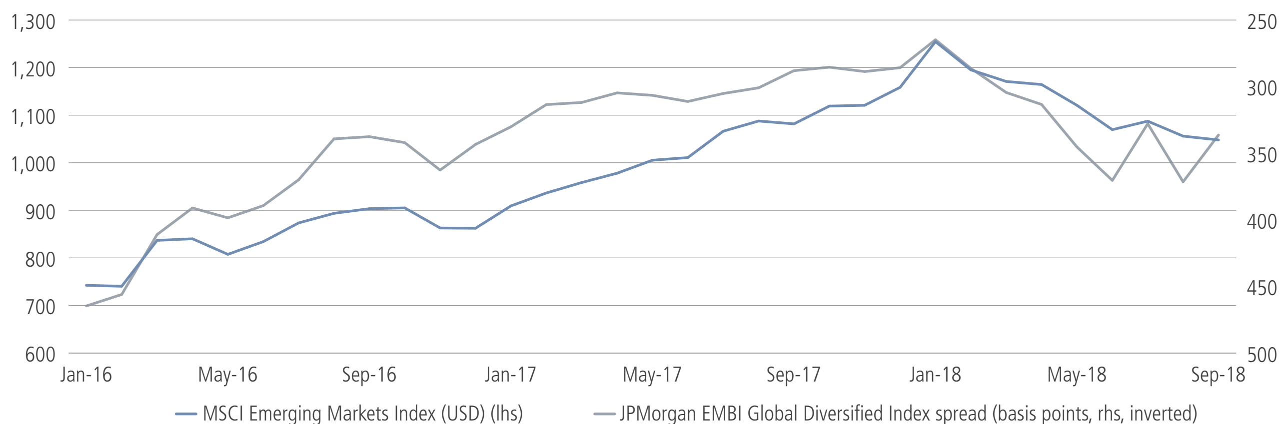
By contrast, emerging market credit spreads and company earnings have shown strong correlation with trade volumes and China's money and credit supply. The longer-term robustness of emerging markets likely turns more on the path of the U.S.-China trade confrontation, and the willingness and capacity of China to apply economic and monetary stimulus, than on the Fed or the dollar. These risks may not be so fully priced.

We address the trade question in our "Up for Debate" section. The more important risk, in our view, is that China feels unable to apply a substantial stimulus in the event of a downturn, as it seeks to avoid the credit excesses of the 2009–10 and 2015–16 stimulus programs.

While China's money and credit growth is indeed still contracting, the authorities have already stopped tightening policy. Market participants expect them to act more aggressively should they need to. Our view is that China will likely act to maintain its domestic growth targets and that, for all the risks of storing up problems for a future date, this will be sufficient to lay the foundations for the last leg of the expansion. Nonetheless, uncertainty is likely to persist for some weeks.

As such, the Committee maintained its overweight view in emerging market equities, with an eye on relative valuations after this year's sell-off, and also kept its overweight view on emerging markets debt, where there was agreement that Argentina and Turkey are apt for deep-value

A REVERSAL FOR EMERGING MARKETS IN 2018



Source: Bloomberg, MSCI. Data as of September 28, 2018. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market or economic behavior. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is not indicative of future results.**

hunting. However, we also maintained a preference for short-duration, hard-currency sovereigns for their attractive yield and moderate risk exposure, acknowledging the risk of another leg down.

Pro-Cyclical or Defensive in the U.S.?

While the AAC's final decision was to remain neutral on size and style in U.S. equities, in its discussion there was a slight preference for smaller and more value-oriented companies. The risks to that view include the possibility that the Federal Reserve is forced to tighten quickly to contain inflation (see "Up for Debate: V-Shaped or U-Shaped—How Might this Cycle End?"), as well as uncertainties arising from the U.S. mid-term elections.

The most likely outcome, and the current market expectation, is for the Democrats to re-take the House of Representatives and the Republicans to hold the Senate. Should the Democrats secure both houses of Congress, uncertainty rises substantially. A number of outcomes are possible that could curtail the cycle—by depressing confidence, super-charging inflation or both. This is why the AAC remains size- and style-neutral in the U.S. for now.

Expectations for Europe and Japan

After moving from an underweight to a neutral view on non-U.S. developed market equities last quarter, we maintained that view—although there was some debate about pushing to an overweight view, due to relative valuations. We maintained our underweight view in non-U.S. developed market debt, however.

In Europe, core sovereign nominal bonds still look expensive and Italy's government has adopted a defiant stance on its budget, although we are more encouraged by the ECB's forward guidance on maintaining negative interest rates well into 2019. In Japan, bonds remain expensive, but equities could benefit from the increasing traction of Abenomics and the weak yen. Both regions are highly exposed to the risk of a worsening trade war between the U.S. and China, and to China's economic slowdown.

Alternatives to Traditional Market Exposure

With so many variables in balance, the AAC's view on overall risk-asset exposure has not changed substantially from the cautiousness of our recent Outlooks.

We still believe there is a place for strategies that provide the potential for market-like returns with lower volatility or non-traditional market exposure. We view absolute return strategies and lower-volatility strategies such as collateralized index put option writing as useful in this environment. In private equity, current deals have worryingly high valuations and very aggressive capital structures, and ultimately we think the ideal time to invest would be at the peak of this cycle and on into the other side. Nonetheless, for its higher return potential over listed equity and the lower volatility profile it brings to an investor's balance sheet, we still consider private assets appropriate for a portion of a balanced portfolio.

A Critical Point

We feel that, if the economy gets through the coming weeks without being derailed by Brazil, Italy, the U.S. mid-terms, Brexit, a trade war, rising U.S. inflation, or a failure of China to stimulate or of Europe and Japan to regain their growth impetus, that would bode well for a continuation of the business cycle through 2019 and 2020. That reads like a long list of risks, but many are interconnected and we regard all of them as containable. When the picture does clear, if things look positive the rebound in sentiment could be sharp—particularly in emerging markets, which have tended to rally strongly after large sell-offs in the past.

Some of the fog could persist into the new year. Realistically, however, investors should be ready to make up their minds on the robustness of the cycle by around the time of the U.S. mid-terms in November. It remains to be seen whether the AAC's views will reflect a desire to seek more shelter from low-volatility, less market-sensitive allocations, or to press home our exposure to a newly robust global growth outlook. Either way, this feels like a critical point in the cycle, and our next AAC report may well reflect a broader and more decisive shift in our asset-allocation views.

> "When the picture does clear, if things look positive the rebound in sentiment could be sharp. Some of this fog could persist into the new year. Realistically, however, investors should be ready to make up their minds on the robustness of the expansion by the time of the U.S. mid-terms in November. This feels like a critical point in the cycle."
>
> ERIK L. KNUTZEN, CFA, CAIA,
> CHIEF INVESTMENT OFFICER—MULTI-ASSET CLASS

UP FOR DEBATE

V-SHAPED OR U-SHAPED: HOW MIGHT THIS CYCLE END?

In an environment in which the rest of the world's economies and markets begin to reconnect with the U.S., and where a capex recovery supports an improvement in productivity, we believe the Federal Reserve can raise rates three times without moving above the neutral rate and triggering a dollar surge or crimping growth. At this rate, with the European Central Bank (ECB) and Bank of Japan (BoJ) still on the sidelines, we think the Fed will have latitude to pause. This is the Asset Allocation Committee's (AAC, "the Committee") core scenario.

We will be looking for global re-convergence, a continuation of recent yield-curve steepening and higher dots for 2020 and 2021 in the Fed's rate expectations chart as confirmation of our core view that the cycle can extend beyond 2020 without rate hikes triggering a slowdown. These outlooks inform our preference, set out last quarter, for short duration in credit markets such as high yield and emerging markets.

As our Fixed Income Investment Strategy Committee wrote in their latest quarterly review, and brought to this AAC debate, the path of U.S. rates implies consequences for the shape of the recession and recovery when this cycle does eventually turn.

Since the early 1990s, we have experienced V shapes: GDP growth moving from around 4% to around -3% and back again within six quarters. The 2008–09 financial crisis was followed by a particularly deep, but still V-shaped recession. Should this cycle extend as we anticipate it to in our core scenario, we might see that again: extension would provide time for excesses to build up in the economy, but also for the Fed to raise rates high enough to make its subsequent cuts meaningful when the recession hits.

The sooner the cycle ends, however, the more likely we are to see a U-shaped recession and recovery—that is, shallower but more prolonged.

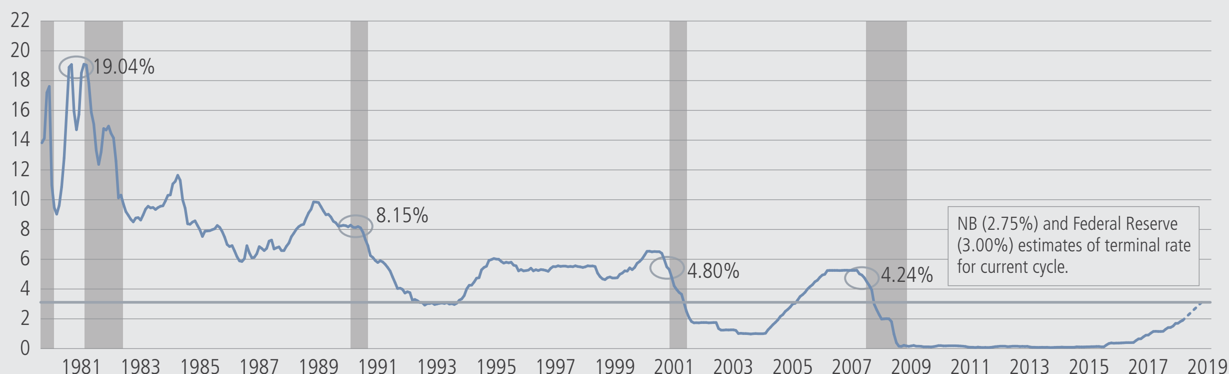
The earlier the cycle ends, the less likely the Fed is to reach the 5%-plus interest rate that prevailed before the four most recent recessions. Moreover, after central banks' innovative responses to the financial crisis, a repeat of that playbook, or even a new departure such as a nominal GDP target, is unlikely to carry the same stimulative element of surprise. Eventually, growth and inflation outside the U.S., and therefore the capacity of the ECB and BoJ to adopt tighter policy, may be an important determinant of how many hikes the Fed can get in before the cycle ends.

On the fiscal side, U.S. policymakers have already enacted $1.5 trillion worth of cuts to corporate and personal taxes, and $300 billion in federal spending increases, even as the business cycle continues to expand. The Congressional Budget Office estimates the federal budget deficit will approach $1 trillion next year—or 4.6% of forecast GDP. U.S. public debt now exceeds GDP. Enacting additional fiscal stimulus in the next recession will be more challenging and potentially less effective, given the starting level of public sector debt.

With these two critical policy levers exhausted, a persistently weak, U-shaped economic recovery could result in an extended period of corporate downgrades and defaults, possibly creating a long and fertile window of opportunity for high yield fallen-angel investments and distressed asset strategies.

THE FED LACKS FIREPOWER

Effective Fed Funds Rate, 1980–2018, with U.S. recessions and starting level of rates shown.



Source: Federal Reserve Bank of St. Louis. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market or economic behavior. Investing entails risks, including possible loss of principal.

UP FOR DEBATE
COULD A TARIFF TUSSLE ARREST GLOBAL GROWTH?

After abandoning the Trans Pacific Partnership in early 2017, the U.S. announced tariffs on imported solar panels and washing machines in January 2018, followed by steel and aluminum in March, before squaring up to Europe over autos. The tone improved with regard to NAFTA partners and Europe over the summer, but, if anything, it worsened with China. The U.S. imposed tariffs on $250 billion of Chinese goods and is set to tax most of the rest of its Chinese imports in the event of retaliation.

The Asset Allocation Committee (AAC, "the Committee") discussed two ways in which a worsening trade conflict could derail the current business cycle. It could damage global growth prospects, and it could cause a rapid rise in cost-push inflation, forcing the Federal Reserve to hike interest rates faster, pushing the dollar higher and choking the global economy of capital and liquidity. How severe are these possibilities?

Some of the second-order effects of the new trade tariffs have been substantial and potentially inflationary—the 30% rise in steel prices and the U.S. government's pledge of $12 billion of support for U.S. soybean farmers are good examples. The dollar's upward march through the summer (and the decline in the Chinese yuan) owed a lot to these forces. But the headline numbers can be misleading. We estimate that the measures currently in play would add only around 30 basis points to core inflation in the U.S. With offsetting weakness in U.S. growth, that is unlikely to frighten the Fed into overly aggressive tightening.

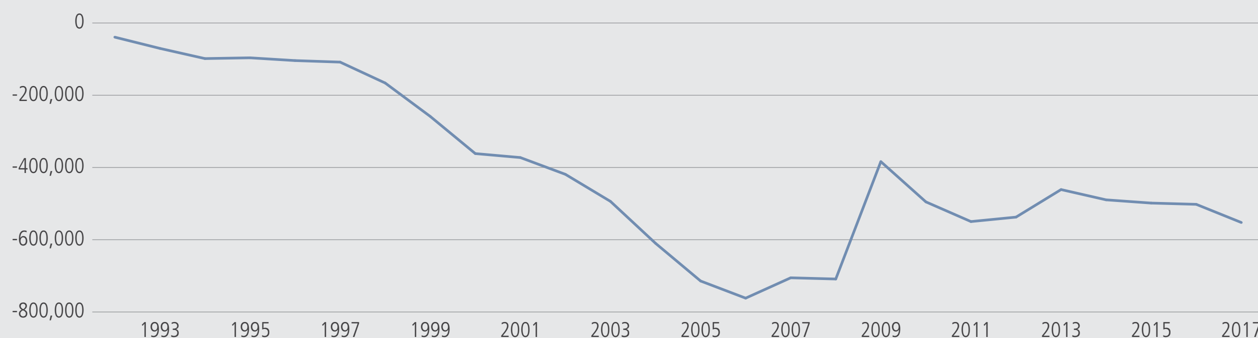
On the growth side, again it is easy for the headline numbers to make prospects look worse than they are. A potential 25% tariff on $500 billion of trade sounds like a big deal, but U.S. exports amount to only 12% of its GDP, and its exports to China just 1% of GDP. The fact that the U.S. has grown at a rate of more than 3% during 2018 indicates the limited impact of the current measures on the broader real economy. We estimate that those measures have cost around 10–20 basis points of that growth, and that further measures currently on the table could erode another 20–25 basis points.

This is not to downplay the risks should relations deteriorate. Fixed Income CIO and AAC member Brad Tank has noted elsewhere that an escalation of hostilities in the automobiles or auto parts sectors would be very damaging given the truly global and integrated nature of that business. Wall Street economists have been quantifying the growth impacts of different outcomes, too. Goldman Sachs has said that 10% tariffs on all Chinese imports to the U.S. could trim three percentage points from its 2019 S&P 500 earnings-per-share estimate, and that a 10% levy on imports globally could slash that estimate by 15 percentage points. UBS has modelled an all-out trade war between the U.S. and China: 30% tariffs on all Chinese imports to the U.S., except smartphones; a proportionate tariff and non-tariff response from China, including a 25% tariff on U.S. cars met with retaliation by the U.S.'s auto-sector partners. It estimated a resulting hit to global growth of one percentage point, from 4% to 3%, with the U.S. and China bearing the brunt, losing two percentage points of growth each.[1]

While this sort of slowdown would not arrest the cycle, it could be enough to shorten it. These are extreme scenarios, however, and a long way from our core view. Our view is that trade tussles will generate a lot of headlines and a fair amount of market volatility over the next six months—but they are unlikely to hole the global economy below the waterline.

THE FOCUS ON THE U.S. TRADE DEFICIT REMAINS A SOURCE OF TENSION

U.S. trade deficit, $m, seasonally adjusted, 1992–2017



Source: U.S. Bureau of Economic Analysis. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market or economic behavior. Investing entails risks, including possible loss of principal.

[1] Goldman Sachs Global Investment Research, July 23, 2018; UBS, *"Trade Wars—What is the impact on growth, inflation and financial markets? A top-down view,"* July 11, 2018.

FIXED INCOME

U.S. Government/Agency: The Asset Allocation Committee (AAC, "the Committee") maintained an underweight view for nominal Treasury bonds. The Federal Reserve increased rates in September for the third time this year. Fed officials have penciled in one more hike for 2018, three in 2019 and one in 2020. The Committee maintained its overweight view for Treasury Inflation Protected Securities (TIPS), as these continue to be attractive as long as inflation risk is skewed to the upside as wages continue to rise and trade tensions raise businesses' input costs.

U.S. Municipal Bonds: The Committee maintained its underweight view in the absence of any catalysts to revise their outlook.

Developed Market Non-U.S. Debt: The Committee maintained its underweight view. The European Central Bank (ECB) will continue to reduce the pace of its bond purchases, but has signaled an accommodative stance on rates given recent weakness in the region's economy. The Bank of Japan (BoJ) continues on its yield targeting strategy, holding yields down on the long end of the curve, although it will now allow the 10-year yield to move within a wider range around the target. Soft inflation has driven the BoJ to continue maintaining its easing path. Nonetheless, overall, sovereign nominal bonds, in particular, still appear expensive.

High Yield Fixed Income: The Committee voted to maintain a neutral view, with a favorable view on short-duration high yield, especially relative to bank loans, as a source of relatively wide credit spreads and relatively low sensitivity to rising interest rates.

Emerging Markets Debt: The Committee maintained its overweight view as the longer-term outlook remains attractive despite short-term volatility and negative sentiment related to global trade tensions. While acknowledging the risk of a further leg down, the AAC believes that the emerging markets sell-off was overdone and that current valuations represent a select buying opportunity, particularly in hard currency debt in Argentina, Turkey and some other fundamentally weaker countries. Stronger countries do not represent the keen value that they did earlier in the summer, however.

EQUITY

U.S. Equities: The Committee maintained a neutral view for U.S. large cap and U.S. small and mid-cap equities. The U.S has maintained strong economic growth despite weaker trends in Europe and China, and is expected to benefit from strong corporate earnings on the back of tax reform, with a bigger benefit likely for small and mid-cap companies. A stronger dollar has also been advantageous to small and mid-caps, as they generate a larger portion of sales domestically. However, GDP could soften when the benefits of tax reform, and of the inventory acceleration implemented in response to rising trade tensions, have been baked into earnings. Those trade and other geopolitical tensions pose a risk, especially for large caps, as does the potential for the Federal Reserve to tighten policy too much or too early. Domestic political risks may rise due to the Robert Mueller investigation or if the Democrats win both houses of Congress in the mid-term elections.

Public Real Estate: The Committee voted to maintain a neutral view on Real Estate Investment Trusts (REITs). After an initial sell-off when rates begin to rise, historically REITs have tended to rebound further into the cycle.

Non-U.S. Developed Market Equities: The Committee maintains a neutral outlook on developed non-U.S equities. In Europe, PMIs have settled at lower levels, which could suggest slower growth, but the ECB remains accommodative even as it prepares to wind down its QE program. Political risk from the Italian budget is a source of volatility. In Japan, a weaker yen could boost corporate earnings, and the BoJ remains committed to its yield targeting policy. In the near future, the BoJ may announce plans to wind down stimulus. In the U.K., Brexit

negotiations hit a rocky patch, representing an additional source of uncertainty as time runs out for a withdrawal agreement.

Emerging Markets Equities: The Committee maintained its overweight view as the longer-term outlook remains attractive despite short-term volatility and negative sentiment related to global trade tensions. The AAC believes that the emerging markets sell-off was overdone and that current valuations represent a buying opportunity. Fiscal policy and monetary easing in China are in the pipeline to counteract a slowdown and the impacts of the trade tensions with the U.S. Nonetheless, dollar strength, trade tensions, China's managed slowdown and continued weak growth more broadly remain key risks.

REAL AND ALTERNATIVE ASSETS

Commodities: The Committee voted to maintain a neutral view in commodities.

Hedge Funds: The Committee maintained its overweight in lower-volatility hedge funds and upgraded its neutral view to overweight in directional hedge funds. Investors are looking for ballast against potential volatility. Correlations between stocks and bonds have tended to be positive in periods of higher economic growth and inflation, and have often reached highs toward the end of the business cycle. Diversification into uncorrelated, low-volatility hedge funds can provide a thoughtful approach to managing risk in periods of increased correlation. More dispersion is being seen across assets, as well as clearer trends in certain markets, creating both long and short alpha opportunities.

Private Equity: The Committee maintained its overweight view. Despite elevated valuations, given a modest portfolio allocation private equity and debt look attractive relative to publicly traded stocks and bonds, providing a likely illiquidity premium and lower mark-to-market volatility. The AAC notes that commitments made to vintages raised at or close to market peaks have tended to outperform over their full cycle due to the lag time before investments are made.

The AAC identified CLO mezzanine tranches, Master Limited Partnerships (MLPs) and collateralized index put-option writing among potential opportunistic allocations.

Currencies

USD: The AAC maintained its neutral view this quarter. Market participants are now quite long after the recent rally, which has left the dollar overvalued based on purchasing power parity (PPP) metrics, but also the U.S.'s twin deficit. Inflation remains stable and Fed tightening is largely priced in; data surprises are turning more neutral and U.S. politics remain uncertain. Risks to the view include the large growth gap with the rest of the world, which is feeding into supportive short-term yield differentials, as well as the haven status of the currency amid trade tensions.

Euro: The AAC maintained its underweight view. The ECB is likely to remain accommodative, as inflationary pressures are still weak and Purchasing Managers' Indexes have settled at lower levels, suggesting growth moderation. Italy's political situation is causing volatility and the U.S. has still to lift the threat of tariffs on European cars. Risks to the view include the ECB normalizing its view on the growth outlook, which forward indicators suggest will remain above trend through 2018, boosted by recovering global activity and the Eurozone's large current account surplus.

Yen: The AAC upgraded its view to an overweight. Japan is growing and running a current account surplus, extremely low unemployment should support inflation, and the recent adjustment to the BoJ's yield-curve policy could be seen as preparing the market for more changes. PPP and real exchange rates suggest the yen is undervalued and, in the Committee's view, the yen remains a valid haven trade during periods of risk aversion. Risks to the view include the wide yield differentials between Japan and other countries, especially the U.S., which are exacerbated by the BoJ's yield-curve policy, recent strong performance and the potential for more positive sentiment should some short-term risks be lifted.

GBP: The AAC maintained its slight overweight view. The GBP remains undervalued based on PPP measures despite data improving markedly after weakness in the first quarter, and job creation and wage growth being stronger than expected. A rate hike from the Bank of England has also tightened yield differentials against the U.S. Risks to the view include market positioning, the fact that data has been weaker outside of the services sector, and the uncertainty of Brexit as negotiating time runs low.

Swiss Franc: 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 Italian political uncertainty causing more haven demand, Switzerland's strong current account balance, and a potential uptick in the country's inflation dynamics or a wider European growth recovery.

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