NEUBERGER BERMAN

Asset Allocation Committee Outlook 3Q20

Venturing Out

Like societies emerging from lockdown, the Asset Allocation Committee is venturing out, cautiously: maintaining quality, but tilting to smaller companies over larger, and leaning a little more into high yield credit and non-U.S. markets where there is reasonable compensation for risk. And these medium-term views are more than usually subordinated to tactical positioning, as momentum-driven markets balance the potential for a strong short-term recovery against the overwhelming likelihood of a long-term struggle back to pre-crisis growth.

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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 28 years of experience.

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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	○	○	●	○	○
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	○	○	○ →	●	○
Non U.S. Developed Market Bonds	○	●	○	○	○
Emerging Markets Debt	○	○	○ →	●	○
REAL AND ALTERNATIVE ASSETS					
Commodities	○	○	●	○	○
Hedged Strategies	○	●	○	○	○
Private Equity	○	○	○ →	●	○

As of 3Q 2020. 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

> "Look at COVID-19 cases in Brazil and compare how well the Brazilian markets are trading—that's very strange. Models don't work right now, and so we have to acknowledge the importance of short-term positioning alongside our medium-term views on fundamentals."

Robert Surgent | Senior Portfolio Manager—Multi-Asset Class

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"We are confident that the economy will be bigger in 12 months' time than it is today, and therefore we are biased toward taking risk. But we are unable to reconcile the the size and speed of the stock market rebound at the beginning of June with what is likely to be a gradual re-opening process and moderate medium-term growth."

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

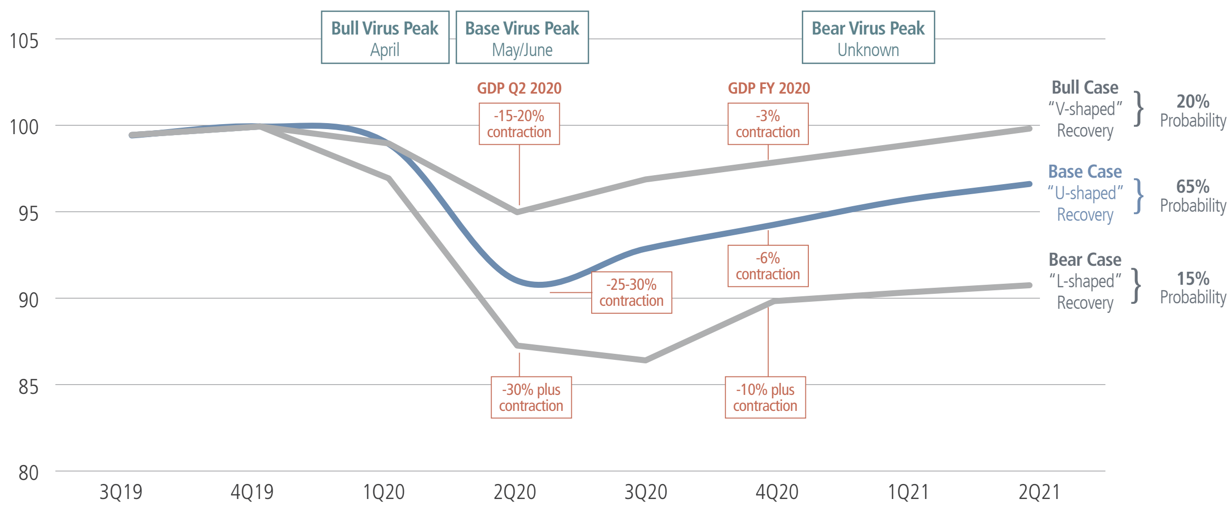
Venturing Out

For many of us, the first signs of normality are returning at last. We are increasingly free to meet family and friends. Growing numbers are returning to work in offices, factories and shops, wearing face masks and following social-distancing protocols. Governments are discussing "travel bridges" to facilitate business and modest summer vacations. At the same time, we know we could be locked down again should the virus stage a serious comeback. The strategy is to venture out, cautiously. The tactics must remain nimble and responsive. Likewise for the latest views from our Asset Allocation Committee. We are venturing out, cautiously: maintaining quality, yes, but tilting to smaller companies over larger, and leaning a little more into high yield credit. We are exploring travel bridges to more cyclical, non-U.S. markets, but only where there is reasonable compensation for risk. And we know that these medium-term views are more than usually subordinated to tactical positioning, as momentum-driven markets balance the potential for a strong short-term recovery against the overwhelming likelihood of a long-term struggle back to pre-crisis growth.

A Strong Recovery, But Not a Full One

The three scenarios that we set out for the U.S. economy at the beginning of April are shown below. Economists' expectations for second-quarter GDP growth range from around -10% at best to as much as -50% at worst. Should those expectations be met, the depth of this crisis would look like our U-shaped or even L-shaped scenario.

WHAT WE SAID AT THE END OF Q1: OUR THREE SCENARIOS FOR THE ESTIMATED PATH OF U.S. GDP GROWTH



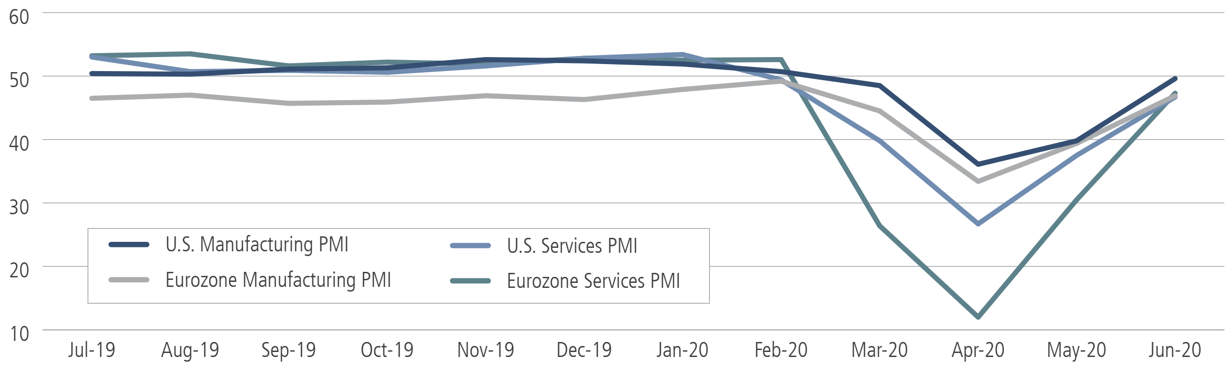
Source: Neuberger Berman. GDP quarterly growth is presented annualized. For illustrative and discussion purposes only. Nothing herein constitutes a prediction of projection of future events or future market or economic behavior. The duration and characteristics of past market/economic cycles and market behavior, including length and recovery time of past recessions and market downturns, is no indication of the duration and characteristics of any current or future market/economic cycles or behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results.

Faster-moving data paint a different picture, however. Instead of losing eight million non-farm jobs in May as expected, the U.S. created 2.5 million. U.S. retail sales jumped by a record 18% in the same month, more than double what had been forecast. These data suggest that employers are re-hiring before government furlough payments come to an end, and that record levels of real disposable income and three months spent sitting at home have left many consumers with a large pile of savings. Re-stocking inventories to meet pent-up demand, which we are starting to see in new orders data, could result in third- and fourth-quarter GDP growth more in-line with the V-shaped scenario.

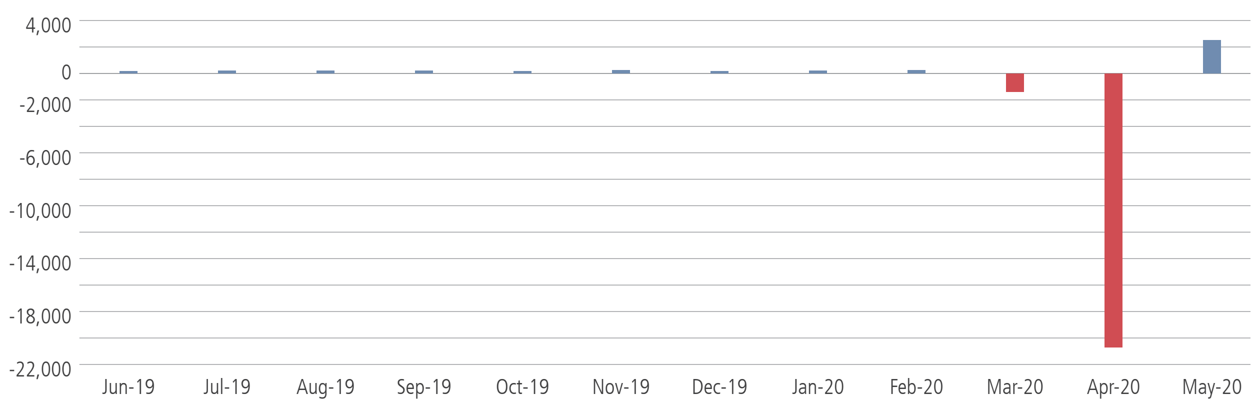
That might explain why some financial markets have appeared so bullish: by June 8, a steep 10-week rally had brought the S&P 500 Index within one percentage point of its starting level for the year.

A REBOUND IN FAST-MOVING DATA

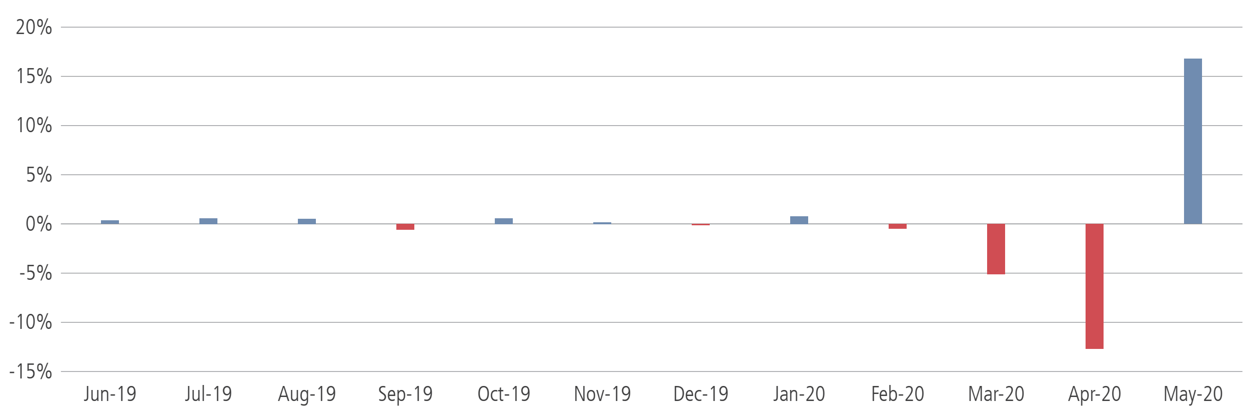
Purchasing Managers' Indices



U.S. Jobs: Month-on-Month Growth in Non-Farm Payrolls (thousands)



U.S. Retail Sales: Month-on-Month Changes



Source: FactSet, Markit, U.S. Bureau of Labor Statistics, U.S. Census Bureau. Data as of June 22, 2020. PMIs for June are preliminary "flash" data.

A strong recovery is not the same as a full recovery, however.

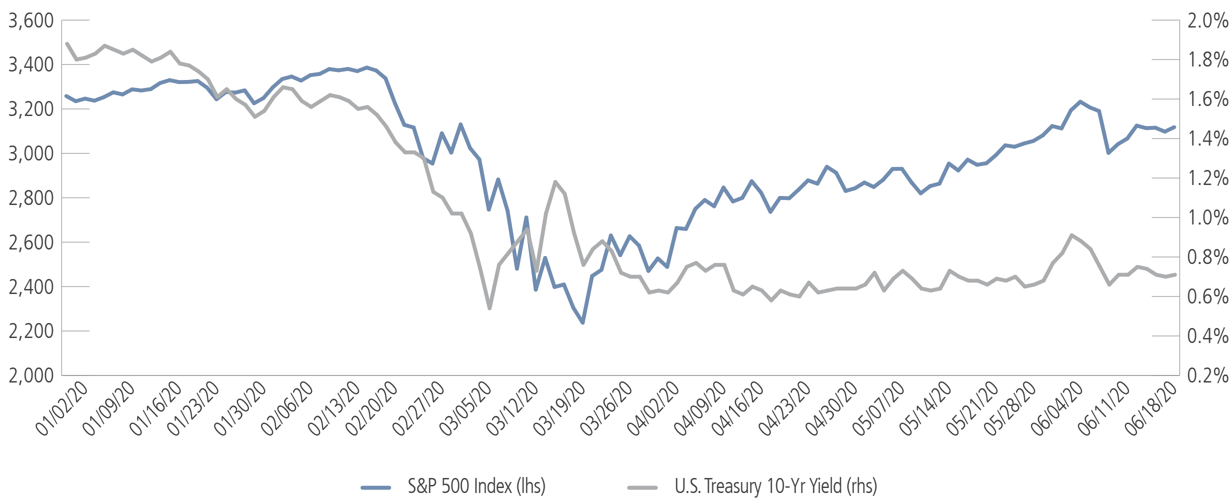
Our U-shaped scenario posits that the economy will not regain its pre-crisis size before the end of next year, and we remain confident in that medium-term assessment. A return to 3.5% unemployment is likely to take even longer—if it happens at all. An initial burst of pent-up consumer demand could be followed by slower spending due to the slow re-opening of service sectors and a cautious maintenance of savings buffers. The pre-crisis conditions of low growth, low interest rates, low productivity and high debt could easily be compounded by even higher debt, even lower rates, higher taxes, tighter regulation, lower consumer confidence, ongoing social distancing and travel restrictions, and a steep cliff edge on the other side of the current fiscal stimulus.

Most of those things we can anticipate with some confidence, and yet when the U.S. Federal Reserve offered a similarly gloomy forecast in the first week of June, it triggered the biggest sell-off in risk assets for two months.

Then there are the risks: subsequent waves of COVID-19 outbreaks and a failure to develop effective treatments or a vaccine; a monetary policy mistake or some hesitancy over fiscal support; a sweeping change of leadership in Washington and a flare-up between the U.S. and China or some other geopolitical hotspot. Add those, and global growth over the next five to 10 years begins to look very fragile.

This might explain why, despite some financial markets appearing so bullish, the U.S. 10-year yield immediately snapped back after breaching the 0.90% level at the beginning of June.

V-SHAPED RECOVERY IN EQUITIES, L-SHAPED IN TREASURY YIELDS… U-SHAPED IN THE ECONOMY?



Source: FactSet. Data as of June 22, 2020. For illustrative purposes only.

Sentiment

It's normal for there to be greater certainty regarding the medium-to-longer-term economic outlook than for the short-term outlook. The current disconnect appears extreme, however, and the drivers of sentiment are unusually complex.

For example, it's difficult to know how market participants will balance the huge headline growth rates for key economic indicators against the Depression-like bases from which they are rebounding. How important are economic fundamentals when we weigh them in the scales next to overwhelming fiscal, monetary and liquidity stimulus? Are rotations into cyclical and value exposures an act of investor caution, reflecting the stretched valuations now evident in quality growth stocks? Or are they reckless, driven by gamblers buying stocks of bankrupt companies based on liquidity, momentum and social-media bluster?

Rather than trying to untangle those forces and reconcile them to medium-term investment views, the AAC found it more productive to draw a firmer than usual line between tilts in their medium-term views and tactical positioning.

From a medium-term perspective, we are confident that the economy will be bigger in 12 months' time than it is today, and therefore we are biased toward taking risk, and both cash and global government bonds are given an underweight view. In addition, while we recognize that many of the possibilities that characterized our L-shaped economic scenario remain in play, we also think that, should that scenario be realized, the magnitude of the stimulus and the extent to which companies and consumers have shored up their balance sheets has likely built a higher floor for equity markets and risky credit than we envisaged three months ago.

Tactically, however, we recognize that many markets appear fully valued for our base-case scenario, and we are unable to reconcile the size and speed of the stock market rebound at the beginning of June with what is likely to be a gradual re-opening process and moderate medium-term growth. We therefore think that such events could be used to take profits at the margin and await a correction.

Historically, those surges and corrections have come roughly every three months during long-term recoveries, with a magnitude of around 7%—but the pattern could be more frequent and more volatile this time, due both to the nature of the uncertainties we are facing, the thinness of securities trading, and the concentration of market leadership in such a small number of mega-cap stocks.

Tilting to U.S. Small-Cap Quality and Non-U.S. Stocks

While we are biased toward taking risk on a medium-term view, conviction is important when markets become fully valued and volatile: when you are confident in a position for the medium term, you are less likely to be shaken out of it in the short term. For the AAC, that means a continuation of the quality theme that we emphasized last quarter, even as we begin to "venture out"—broadening our investment universe beyond the focus on U.S. large company growth stocks and investment-grade credit as we become more confident in a U-shaped outcome.

In U.S. equities, that translates as a tilt in our views away from large-cap growth, but not in favor of large-cap value or cyclical stocks so much as quality businesses among small and mid caps, where valuations have lagged the market.

Regionally, while Committee members have become less wary of emerging markets, we remain skeptical that an overweight view for equities is justified. While China, much of Asia and emerging Europe have made good progress in controlling and recovering from COVID-19, there are hotspots such as Russia, India and Latin America, where the situation is still worsening and the capacity for infection control and fiscal stimulus is lower. Neither are global emerging market equity indices cheap—they are down less than half as much as U.S. small caps, year-to-date.

Japan was again cited as a potential source of high-quality cyclical exposure, with some caveats about the extent of the central bank's involvement in its equity market. The Committee's view on Europe was also upgraded following encouraging moves from Germany, France and the European Commission on a more unified fiscal response to the COVID-19 crisis. While a failure on that front and a messy Brexit remain key risks, European equity valuations are among the most attractive in the world.

In fixed income, while it now appears that policy rates in the U.S. are likely to be anchored around zero for two years or more, it remains difficult to make a case for an overweight view on cash or government bonds, except as a destination for profits booked tactically from risk assets. Our credit teams have more conviction on the higher-quality segments of high yield on a 12-month view, now, but they expect spreads to trade in a fairly tight range, increasing the importance of tactical positioning.

Whereas emerging markets equity remains a step too far for an overweight view, the AAC sees emerging markets debt as a lower-risk way to get exposure to the global recovery. Partly because emerging debt indices are heavily weighted to Latin American countries struggling with COVID-19, the asset class appears to be trading significantly cheaper than emerging equities, where indices are more exposed to Asia. That makes a strong case for active management, and the AAC is also focused on the specific opportunity in China onshore bonds: this market was impressively resilient even at the height of the crisis and could prove to be an attractive, high-yielding source of exposure to the recovery.

In alternatives, focus is shifting away from the more market-neutral exposures of hedged strategies toward the long-term growth exposures of private markets—although we still believe that strategies designed to harvest elevated equity and volatility risk premia, such as put-option writing, have a role to play. History suggests that some of the best private equity vintages are those raised at the top of public markets and the onset of recessions, as their dry powder gets invested during the downturn. The 2019 and 2020 vintages may turn out to be an extreme example of that phenomenon, albeit with similarly extreme dispersion between the performance of the best and the worst funds.

The Committee continues to see a big opportunity for co-investments in corporate restructurings. We believe many companies will struggle to refinance with traditional bank loans and bond issuance over the coming months, and that is likely to generate meaningful opportunity for private debt strategies. More recently, we have been pleased to see the private equity secondaries market begin to open up, with reasonable bid-ask spreads on opportunities offered by both Limited Partners and General Partners. This is likely to be a multi-year opportunity, given the deep impact of the COVID-19 crisis. Finally, while the AAC identified structured credit as a key area to explore three months ago, spreads there have snapped back rapidly—as in high yield, a tactical approach may now be called for, with new entry points possible during future periods of volatility.

Advancing and Retreating

Turning back to the scenarios that we set out at the start of April, it seems clear that many financial markets are pricing in a V-shaped recovery. Some fast-moving economic data appear to support that bullishness. Broader data and a longer-term outlook are still more in line with our base case of a U-shaped outcome, however. And while we think that the potential severity of our L-shaped scenario has been somewhat mitigated, many of the possibilities it describes—a second wave of coronavirus infections, a cycle of lockdowns that increase economic and financial stress, or a serious geopolitical fallout—are just as live now as they were three months ago.

That sense in the economy and the markets of growing optimism but wide uncertainty echoes what we face in the rest of our lives. We cautiously "venture out" to work and leisure again, but we still can't enjoy many of the good things in life and the economy, from eating out to theatre nights to cheering at the ballgame, and we watch the pennies, knowing that we may have to retreat at any sign of a comeback for the virus. At the same time, the AAC is venturing out beyond the safer havens with its medium-term investment views, while acknowledging that short-term dynamics will likely drive tactical decisions to advance toward or retreat from risk.

FIXED INCOME

Investment Grade Fixed Income

- The Asset Allocation Committee ("AAC" or "the Committee") maintained its overweight view.
- Interest rates are likely to remain low for a long time and corporates are likely to maintain very conservative balance sheets.
- Central banks appear committed to supporting liquidity in these markets.
- While spreads have tightened, continued strong support from central banks and ample liquidity means they can continue to grind still tighter.

Developed Market Non-U.S. Debt

- The Committee maintained its underweight view, having upgraded from a heavy underweight last quarter.
- While rates in Europe and Japan are still below those in the U.S., rate cuts from the Federal Reserve have narrowed the differential and rates worldwide are likely to remain low for a long time.
- The AAC's views on Europe has improved following the leadership of Germany and France in promoting a large, common fiscal response financed by bond issuance by the European Commission.

High Yield Fixed Income

- The Committee upgraded its view to overweight.
- An environment of low rates and conservative management of corporate balance sheets will be supportive of credit markets in general.
- While high yield could be one of the sectors hardest hit by the COVID-19 fallout, with meaningfully increased risk of defaults, the AAC sees select opportunity in higher-quality segments of the market given ongoing moves to re-open the economy.

Emerging Markets Debt

- The Committee upgraded its view to overweight.
- Because emerging markets debt indices are heavily weighted to Latin American countries struggling with COVID-19, the asset class appears to be trading relatively cheaply.
- There are regionally specific opportunities among countries with stronger institutions, exposure to the earlier signs of recovery in China, and industries that consume rather than produce commodities.
- The AAC favors China onshore bonds, specifically; resilient at the height of the crisis, this market could prove an attractive, high-yielding source of exposure to the recovery.

GLOBAL EQUITIES

U.S. Equities

- The Committee downgraded its view on U.S. large caps back to neutral and upgraded its view on U.S. small and mid caps to overweight.
- U.S. large caps have led the rapid recovery in financial markets and now appear fully valued.
- While smaller companies are generally more leveraged and also more vulnerable to the economic impact of the COVID-19 outbreak, the AAC believes a tilt toward higher-quality small caps is justified given their more attractive valuations and ongoing moves to re-open the economy.

Non-U.S. Developed Market Equities

- The Committee moved from a neutral to an overweight view.
- U.S. large caps have led the rapid recovery in financial markets and now appear fully valued, whereas Japanese and European equities remain relatively cheap.
- European equities are also geared to global trade, and while the risk of a no-deal Brexit at the end of this year remains in place, the AAC's views on the region have improved following the leadership of Germany and France in promoting a large, common fiscal response financed by bond issuance by the European Commission.
- Japan may be a source of higher-quality exposure to cyclical stocks and a revival in global trade than riskier emerging markets.

Emerging Markets Equities

- The Committee maintained its neutral view.
- Many emerging countries appear vulnerable to a crisis in healthcare systems, to disruption in supply chains and to commodity market weakness and U.S. dollar strength.
- There may be regionally specific opportunities among countries with stronger institutions, exposure to the earlier signs of recovery in China, and industries that consume rather than produce commodities.
- Notwithstanding growing risks in Latin America, in particular, valuations have recovered significantly.

REAL AND ALTERNATIVE ASSETS

Commodities

- The Committee maintained its neutral view.
- A ceasefire in the OPEC+ oil price war was achieved sooner than we anticipated, and crude futures prices have recovered from their unprecedented plunge below zero in April.
- While the medium-term outlook is disinflationary, commodities could provide exposure to a surge in pent-up demand from consumers and manufacturers in the immediate term, and over the longer term, the potential for higher inflation as a result of the current stimulus efforts could be positive for the asset class.

Hedge Funds

- The Committee maintained its underweight view.
- After providing much-needed ballast for portfolios through the worst of the COVID-19 crisis, liquid alternatives have less of a role to play as the recovery gains a firmer footing.

Private Equity

- The Committee moved back to an overweight view.
- Vintage years raised at the peak of public markets or in the early stages of recession have historically delivered among the best returns, albeit with wide dispersion.
- There are emerging opportunity sets in co-investments in corporate restructurings, private lending and distressed strategies.
- Private equity secondaries could present a multi-year opportunity as both General Partners and Limited Partners seek liquidity to restructure portfolios.

Currencies

USD

- The AAC maintained its underweight view.
- Despite recent weakness, the currency is still overvalued based on purchasing power parity (PPP) metrics and market participants remain long the currency.
- U.S. interest rates are likely to remain low for a long time, which could weaken the dollar as risk appetite recovers.
- The U.S. will likely be the last major economy to endure a peak in COVID-19 cases, and it has so far lagged many other countries in testing for the virus.
- The twin deficits that the U.S. runs are likely to be exacerbated by stimulus efforts to counter the economic impact of the COVID-19 outbreak.
- Risks to the view include the continued growth differential with the rest of the developed world, which may rebound slightly as the U.S. rushed to re-open its economy despite the health risks; the ongoing, albeit narrower short-term rate differential with the rest of the developed world; and the potential for risk appetite to deteriorate still further should COVID-19 infections spike again.

EUR

- The AAC upgraded its view from underweight to neutral.
- The AAC's views on the region have improved following the leadership of Germany and France in promoting a large, common fiscal response financed by bond issuance by the European Commission.
- The euro remains undervalued on PPP metrics and market participants are still moderately short the currency.
- Risks to the view include the dovish stance of the ECB in response to the COVID-19 crisis; exposure to global growth should COVID-19 infections spike again; and the possibility that the European Recovery Fund fails to find support across the eurozone.

JPY

- The AAC maintained its overweight view.
- Japan runs a current account surplus, has exposure to the recovery in global trade, and is likely to be only marginally affected by the postponement of the Olympic Games.
- Both PPP and real exchange rates suggest the JPY is undervalued, which means long yen is likely to remain attractive during any return of risk aversion.

- Falling yields globally make Japan's low rates less discouraging.
- Risks to the view include the ongoing yield differentials in both nominal and real terms with the U.S.; funding stresses within Japan; and a decline in demand for havens should risk sentiment continue to rebound.

GBP

- The AAC maintained its overweight view.
- The GBP is back near to its post-Brexit lows and appears undervalued based on PPP measures, and the market is now short the currency.
- While the U.K. has acted comparatively slowly on testing and containment, its fiscal response to the COVID-19 crisis has been among the strongest and broadest and the slowdown in the economy will boost the trade balance.
- Falling yields globally have improved interest rate differentials in GBP's favor.
- Risks to the view include rising political uncertainty as the potential for a no-deal Brexit at the end of this year remain live; and high exposure to the downturn in retail, tourism and services due to the COVID-19 outbreak.

CHF

- The AAC upgraded its view to neutral.
- Switzerland runs a persistent current account surplus and its large pharmaceuticals sector may get a boost from the fight against COVID-19.
- Falling yields globally have improved interest rate differentials in CHF's favor.
- The currency remains a potential haven from political uncertainty, particularly around Brexit.
- Particularly following recent strength on the safe-haven trade, the CHF appears very overvalued based on PPP measures.
- Policy action by the SNB appears to be underpriced and the persistent strength of the currency continues to keep inflation low.
- Risks to the view include the currency's overvaluation on PPP measures; the relief of political pressures should a compromise be reached on the European Recovery Fund; the active stance of the Swiss National Bank in weakening CHF to sustain domestic inflation; and the continued attractiveness of CHF as a funding currency for global carry trades.

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