NEUBERGER BERMAN

Asset Allocation Committee Outlook 4Q22

Tighter Conditions Begin to Squeeze the Economy

The Asset Allocation Committee ("the AAC" or "the Committee") has thought for some time that markets were over-optimistic on both inflation and corporate earnings, even as valuations tumbled this year. An epic climb in short-dated rates and bond yields appear to reflect investors' acceptance of central banks seriousness about fighting inflation, but many still seem reluctant to price for substantially lower earnings. We see fixed income markets offering yield again at last, but we anticipate further volatility not only for risky assets, but potentially for government bonds, too, as conditions tighten further. Diversification and managing risks are our watchwords ahead of a potentially difficult winter.

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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 30 years of experience.

COMMITTEE MEMBERS

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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	○	○	○	●	○
Private Debt	○	○	● ←	○	○
Private Real Estate	○	○	○	●	○

As of 4Q 2022. 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

	Underweight		**Neutral**	Overweight	
REGIONAL EQUITIES					
Europe	○	●	○	○	○
Japan	○	○	○	●	○
China	○	○	●	○	○
India	○	○	●	○	○
Brazil	○	○	●	○	○
REGIONAL FIXED INCOME					
U.S. Treasury 10 Year	○	●	○	○	○
Bunds 10 Year	○	●	○	○	○
Gilts 10 Year	○	●	○	○	○
JGBs 10 Year	○	●	○	○	○
EMD Local Sovereign	○	●	○	○	○
EMD Hard Sovereign	○	●	○	○	○
EMD Hard Corporates	○	○	●	○	○
CURRENCY					
Dollar	○	○	●	○	○
Euro	○	○	●	○	○
Yen	○	○	○	●	○
Pound	○	●	○	○	○
Swiss Franc	○	○	●	○	○
EM FX (broad basket)	○	●	○	○	○

"We're not getting a flood of companies telling us that things are dire, but we are starting to see misses on earnings. A lot of analysts are still trying to rationalize these misses as idiosyncratic. But in our view there's little doubt they reflect the deteriorating macro environment."

Timothy F. Creedon, CFA | Director of Global Equity Research

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"Opportunistic investments are beginning to develop, but patience could be a virtue in this environment; it is likely to contain a lot of falling knives, while also giving investors time to build positions once the market has reached its trough."

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

Tighter Conditions Begin to Squeeze the Economy

Two days after the Asset Allocation Committee ("the AAC" or "the Committee") released its last, cautious *Outlook*, the MSCI All Country World Index of global equities began a five-week, 12% rally. The mid-summer exuberance did not shake our conviction. We were convinced it was based on an over-optimistic reading of short-term inflation data, as well as corporate earnings resilience and the willingness of central banks to ease sooner rather than later. By the time the Committee reconvened in late September, the yield on two-year U.S. Treasuries had been on an epic climb above 4.25% and equities had slumped back to 2022 lows. But if investors appear to have accepted that central banks are serious about fighting inflation, many still seem reluctant to acknowledge that corporate earnings forecasts are likely to be downgraded further, given the tightening financial conditions and economic slowdown. As a result, we anticipate further volatility and downside for global stock markets. At the same time, while we continue to favor quality and short duration in credit, the yield we now see available can cushion a lot of potential spread widening. Although not outright bullish on credit, we favor it over equity as a way to build return potential into our views while moving up the capital structure. Overall, diversification and managing risks are our watchwords ahead of a potentially difficult winter, informing positive views on cash and uncorrelated macro trading strategies. At the moment, we think early summer 2023 may see an upgrade of our views on risk. Now is not the time.

We have been arguing for more than a year that global inflation is likely to be stickier and more problematic over the next few cycles—even before the invasion of Ukraine threw more fuel on the fire. Deglobalization and decarbonization of the world economy, demographic and policy shifts in China, a stronger bargaining position for labor relative to capital, a growing tilt to fiscal populism and ongoing pressure for central banks to err on the side of accommodative policy—we see these as some of the most important global macro trends, and we view them all as inflationary. This is a central premise behind a set of long-term views we set out in our recent publication, *Investing at a Crossroads: Three Themes for Today's New Challenges*.

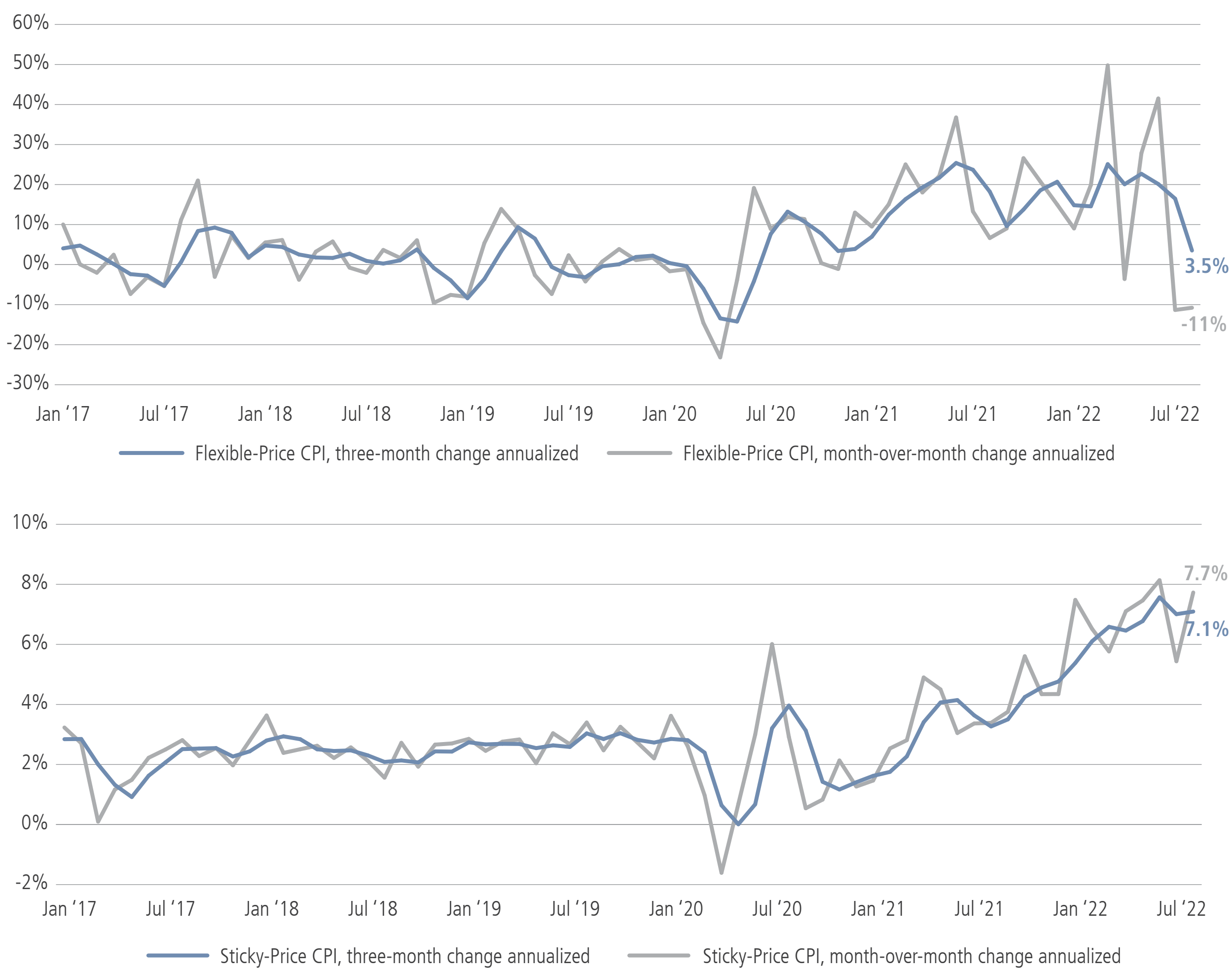
Therefore, when data released on August 10 showed quite a steep drop in the U.S. Headline Consumer Price Index (CPI) inflation rate in July, we greeted the news more cautiously than most. We do expect inflation rates to peak in coming months, but we also think the road back to something more normalized is going to be long and bumpy.

Stickier Inflation, Slower Growth

It is instructive to consider the Federal Reserve Bank of Atlanta's disaggregated baskets of the "Sticky-Price" and "Flexible-Price" components of the U.S. CPI. The decline in inflation in July was almost entirely a result of Flexible-Price items, which make up around 30% of the CPI. These are mostly consumer goods and fuel, which are quick to adjust and tend not to reflect the things that central banks focus on: longer-term inflation expectations or labor-market imbalances.

By contrast, inflation in Sticky-Price items remains high. Those items are mainly services, many of which are contractual or exhibit low price elasticity, and as such they tend to reflect labor market conditions and embed themselves into consumers' expectations for longer-term inflation. That is why central banks pay closer attention to them, and why the rising temperature in that part of the CPI basket was such a cause for concern for us back in the summer. When U.S. inflation data for August was released on September 13, it suggested that the decline in Headline Inflation was stalling as the heat spreads through Sticky-Price items—causing a decisive end to the brief rally in equities and putting a rocket under government bond yields.

WHILE FLEXIBLE-PRICE INFLATION HAS BEEN DECLINING, STICKY-PRICE INFLATION APPEARS STRONG



Source: FactSet, Neuberger Berman. Data as of September 13, 2022. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

High inflation suggests tighter monetary policy will likely persist, and as the U.S. Federal Reserve (Fed) has become more hawkish, both in messaging and in action, central banks around the world have scrambled to keep up with their own rate hikes or currency-market interventions. In a matter of months, short interest rates around the world have risen from historic lows to levels unseen since the Great Financial Crisis (GFC).

INTEREST RATES: FROM HISTORIC LOWS TO A 14-YEAR HIGH IN A MATTER OF MONTHS

Average of global short interest rates (basis points)

Source: Evercore ISI. As of September 21, 2022. The chart shows three-month market rates for the U.S., U.K., Eurozone, Japan, Canada, and Australia (65%, GDP weighted) and for India, China, HK, Korea, Taiwan, Indonesia, Malaysia, Philippines, Singapore, Thailand, Brazil, Mexico, Argentina, Poland, Czech Republic, and Hungary (35%, equally weighted within regional sub-categories that are then GDP-weighted). For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

That tightening in financial conditions is darkening many economists' economic growth outlooks. The Organisation for Economic Co-operation Development's (OECD) latest forecast for global growth in 2022 is now down to 3%. It cut a further 60 basis points from its 2023 forecast, which now stands at 2.2%. It cut a full percentage point from its U.S. growth forecast for this year, to 1.5%, and now expects the U.S to grow by just 0.5% next year. This is now in line with the economic forecasts aggregated by Bloomberg. The OECD also warned that a cold northern hemisphere winter could leave 2023 European growth another 1.25 percentage points lower and push down global growth another 0.5 percentage points.

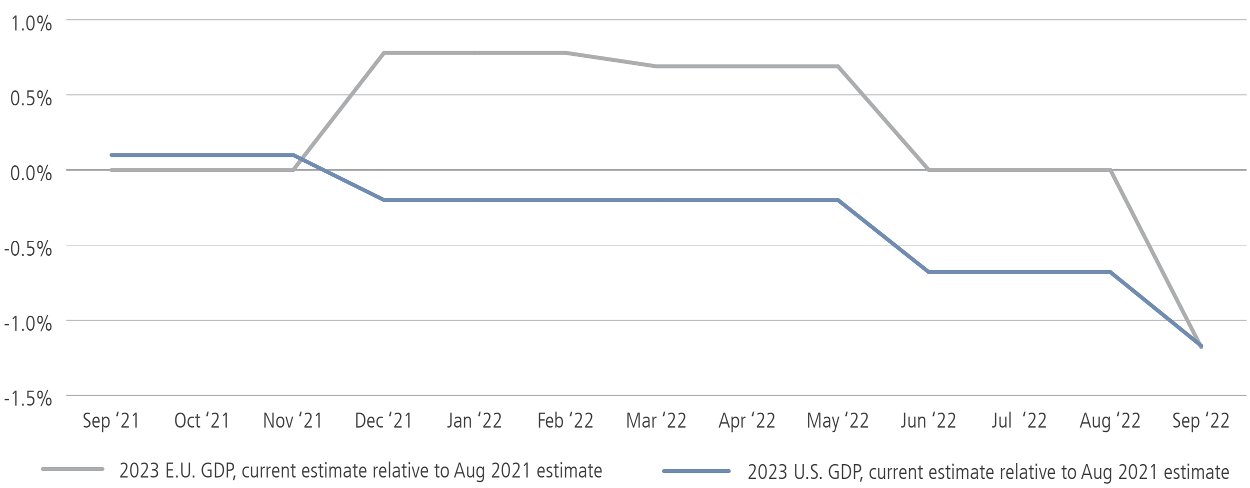
Equities: Declining Earnings

We now believe the U.S. and Europe are heading into a mild recession—more like 1980, 1990 or 2000 than 1973, 2008 or 2020, for example—but even a mild recession is likely to lead to a decline in corporate earnings.

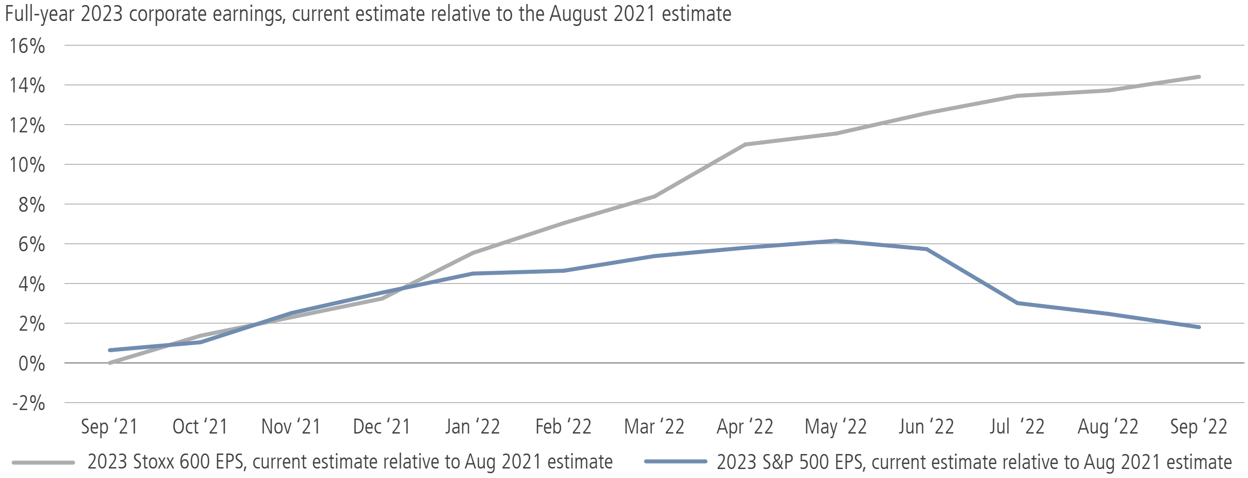
Here we see a notable divergence between macro and micro forecasts. Since August 2021, the Fed has downgraded its forecast for 2023 U.S. GDP by 1.2%. The European Central Bank (ECB) was initially more optimistic, but as the Ukraine crisis has developed it has ultimately downgraded its forecast for 2023 European Union GDP by the same amount. According to FactSet data, however, the mean analyst's outlook for S&P 500 Index earnings per share in 2023 is still 2% higher than it was in August 2021, and the outlook for STOXX 600 Index earnings is more than 14% higher. The high levels of nominal relative to real GDP growth, due to persistent high inflation, may be muddying the picture, but ultimately we think this is much too optimistic and leaves more downside to be priced into equity markets.

MACRO VS. MICRO: GDP GROWTH REVISED DOWN, BUT NOT EARNINGS GROWTH

Full-year 2023 Real GDP, current estimate relative to the August 2021 estimate



Full-year 2023 corporate earnings, current estimate relative to the August 2021 estimate



Source: U.S. Federal Reserve, European Central Bank (top); FactSet (bottom). As of September 2022. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Investing entails risks, including possible loss of principal. Indexes are unmanaged and are not available for direct investment. **Past performance is no guarantee of future results.**

Our own Equity Research analysts report that, while they are not hearing a marked turn to pessimism from corporate management, a growing number of the companies they monitor have either cut their earnings projections or have signaled increasing uncertainty. They anticipate deteriorating news as higher rates and energy prices begin to bite, and they think current U.S. earnings forecasts might fall by 20% or more in the event of a recession.

The downside could be exacerbated because the earnings reported by S&P 500 companies appear to exhibit the poorest quality for at least 30 years. What do we mean by that? As the chart below suggests, these companies have been making aggressive use of accruals in their accounting—revenues or liabilities that have yet to be realized as cash flows. When growth slows, accrued revenues can quickly lose a lot of their value, as we can see in the relationship between accrual values and the ISM Manufacturing Index. The recent rollover in that Index suggests that the accruals tide may be about to turn.

S&P 500 EARNINGS QUALITY APPEARS TO BE AT A GENERATIONAL LOW AND MAY BE DUE A CORRECTION

ISM Manufacturing Index versus S&P 500 Index accruals lagged by three quarters

Source: Piper Sandler, Neuberger Berman. Data as of August 31, 2022. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Against this background, the AAC elected to maintain an underweight view across equity sectors. Within equities, we currently look for lower beta stocks both in terms of sensitivity to the market but also the economic cycle. We still favor value over growth to moderate sensitivity to rising rates, but regardless of style our views are biased toward larger, higher-quality, more defensive companies with strong balance sheets and conservative accounting.

Regional preferences are marginal, but our view is tilted toward the U.S. over non-U.S. markets given the AAC's overall caution on risk. Some Committee members see relative value opportunities in certain parts of the European market, but the macro challenges are so formidable that to many, investing would feel like trying to catch a falling knife. China, and especially China large-cap technology, also looks relatively cheap, but there is still a lot of uncertainty around the zero-COVID policy, the outcome of the National Congress in October and the nature and size of any stimulus that might come after it, longer-term demographic challenges, and the sustainability of the country's debt and growth profile. There is somewhat more conviction on Japan, where valuations are lower than at any time since the GFC, making it around 30% cheaper than the U.S. market, and an export-oriented market is supported by the weakest yen in more than 20 years. Even here, we strike a note of caution: Japan's highly cyclical industrial economy makes it positively exposed to any recovery in China but also negatively exposed to the global slowdown. In Japan, as in Europe, selectivity may be helpful: the tourism sector could benefit from re-opening and the weak yen without so much exposure to the industrial slowdown.

Fixed Income: Seeking to Balance Our Overall View on Risk

Given our inflation outlook, the Committee anticipates volatility in fixed income and rates markets for some time to come—and therefore we maintain an underweight view on core global government bonds. That said, yields are beginning to look attractive across a growing swath of the fixed income markets as a potential source of both income and diversification. (See "Up for Debate: Are Bonds Back?".)

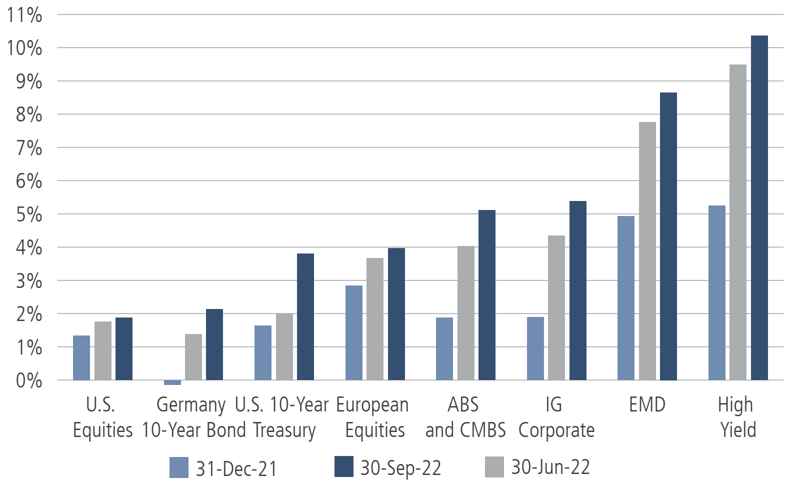
BOND YIELDS HAVE RISEN RAPIDLY THIS YEAR…

Yield to maturity from benchmark sovereign markets and global credit indices

Source: FactSet. Data as of September 30, 2022. Indices use are the Bloomberg Global Aggregate Corporate Index (Global Investment Grade Corporate), Bloomberg Global High Yield Index (Global High Yield) and JPMorgan EMBI Global Index (Global Emerging Markets Debt). For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Investing entails risks, including possible loss of principal. Indexes are unmanaged and are not available for direct investment. **Past performance is no guarantee of future results.**

… MAKING THEM NEWLY COMPETITIVE WITH EQUITY

Yields, and asset classes ranked by yield levels at December 31, 2021 and September 30, 2022



Despite declining valuations, equity dividend yields have lost ground against fixed income yields this year

December 2021	September 2022
Germany 10-Year Bond	U.S. Equities
U.S. Equities	Germany 10-Year Bond
U.S. 10-Year Treasury	U.S. 10-Year Treasury
ABS and CMBS	European Equities
IG Corporate	ABS and CMBS
European Equities	IG Corporate
EMD	EMD
High Yield	High Yield

Source: FactSet. As of September 30, 2022. Fixed income yields are yields to maturity; equity yields are yields on next 12 months' estimated dividends. Indices used are the S&P 500 Index (U.S. Equities), STOXX 600 Index (European Equities), Bloomberg ABS+CMBS Index (ABS and CMBS), Bloomberg Global Aggregate Corporate Index (IG Corporate), JPMorgan EMBI Global Index (EMD) and Bloomberg Global High Yield Index (High Yield). For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Here, our watchwords are shorter duration and higher quality. For now, we think the yield available in emerging markets debt is outweighed by the risks of dollar strength and the challenging general macro outlook. But short duration TIPS look attractive next to cash, with real yields now well in excess of 1%; investment grade corporates and, increasingly, some parts of structured credit look increasingly attractive; and flat credit curves mean that short-duration non-investment grade bonds are offering attractive yield with moderate interest rate risk.

The Committee sees high yield as a relatively low-risk way to retain return potential should investors choose to reduce their equity exposure—rather than a call for outright bullishness. That is why we retain a neutral view for now. We also think it is vital to be cognizant of credit risk as the growth slowdown develops, particularly in an inflationary slowdown where corporate borrowers may need to refinance at meaningfully higher rates. That "maturity wall" issue could be a challenge for loan markets, in our view, but less so for high yield bonds: because companies took advantage of COVID-era low rates to build their cash balances and extend maturities, only 8% of the U.S. high yield market matures before 2025, for example.

Our Fixed Income team's most recent default outlook reflects this dynamic. For the constituents of the ICE Bank of America U.S. High Yield Index, even in the case of a recession in which markets close to new issuance and spreads widen meaningfully, we think defaults will remain relatively modest over the next few years by the standards of historical slowdowns.

The average quality of the high yield market is high relative to history. Almost 41% of U.S. new issuance from the past two years has been rated BB or above. Only 38% of the proceeds were used to add leverage via acquisitions, buyouts, dividend payments or other corporate actions; the rest was dedicated to refinancing at historically low rates. That said, against the current macro outlook, the AAC favors the higher-quality segment—and it's important to note that, in our view, the yields on offer at this level remain attractive. At October 10, U.S short-duration BB high yield bonds yield just over 7%, on average, next to almost 9% for the full market in short-duration U.S. high yield. While holding bonds like these to maturity could be a bumpy ride through a recession, we also think strong demand from insurance companies and other institutional investors that have been waiting for this level of yield for a decade could help to cushion that ride.

UP FOR DEBATE: ARE BONDS BACK?

The scale and speed of this year's run-up in bond yields have been very unusual. The last time we saw anything like it was in 1994.

It has left us with yields higher than they have been for more than a decade, and we think there is a strong argument that the contribution of the bond market to the necessary tightening of financial conditions may be almost done. Committee members from our Fixed Income team tell us that they believe a number of government bond market yields may be close to the highs they are likely to reach, at least until the recovery from the ongoing economic slowdown. Heightened bond market volatility could remain a feature, but they see it as increasingly two-way rather than biased to lower bond prices.

They also note that investment grade and high yield credit spreads appear to provide a good buffer relative to expected defaults, even in many weaker economic scenarios, and that many emerging market yield curves have repriced well ahead of their inflation cycle. This has already led the Committee to adopt an overweight view on investment grade corporate bonds at the start of the third quarter, and it informs an increasingly favorable view on high-quality high yield relative to both private debt and equity.

Does it also change the AAC's view on diversification and the potential efficacy of the 60/40-style portfolio? To some extent, yes.

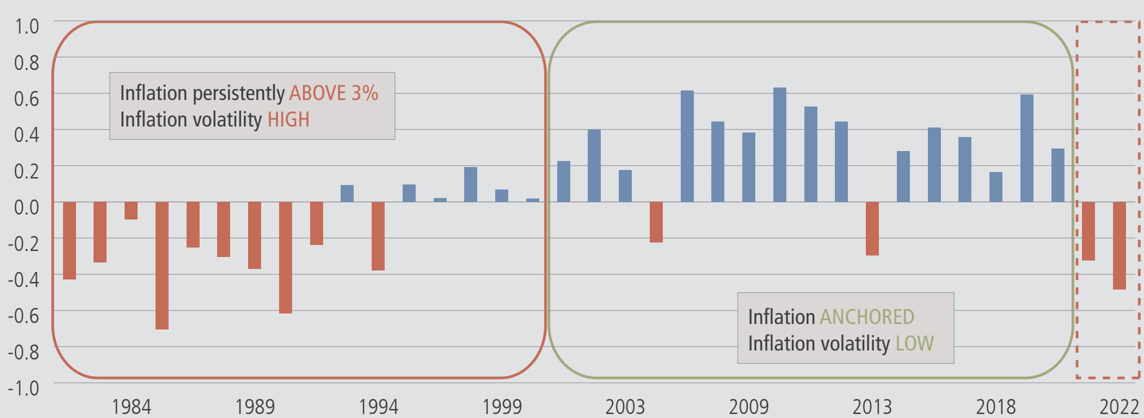
The inflation-driven rise in rates and bond yields has led to mark-to-market losses on many assets, causing a spike in equity-bond correlation and a lack of any diversification buffer against this year's sell-off. With a high risk of more downside to come in equity markets, and having already been bitten this year, investors may be wary of trusting bonds for diversification.

However, we believe the yields now available and the gravitational "pull to par" of bonds moving toward maturity make them much more attractive than they were at the start of the year. We think that means investors will be more likely to turn to bonds when risky assets come under selling pressure, and it could also mean that bond yields have further to fall before investors are tempted to sell out of them again. We believe that can allow government bonds to return to their traditional role as a diversifier in stress environments, particularly when fears around growth are rising. As bruising as the past nine months have been for 60/40 and other balanced portfolios, bonds have the potential to deliver a smoother ride as we go through the current slowdown facing the possibility of further downside in equities.

Looking beyond the current cycle, as long as fears about inflation remain, we still believe bonds are likely to be less effective diversifiers than they were between 2000 and 2020. Then, inflation was low and stable, and yields were in a strong downward trend. Over the coming years, we believe strong macro forces will keep inflation at a structurally higher level than we've become used to. But over the coming months, it is likely to decline. That could mean that some of the worst weeks and months of this new era's downside correlation are already behind us.

GOVERNMENT BONDS HAVE TENDED TO BE LESS DIVERSIFYING WHEN INFLATION WAS STRUCTURALLY HIGHER

Average U.S. 10-year Treasury return on days when the S&P 500 Index ended down by 2% or more



Source: Bloomberg. Data as of April 2022. For illustrative purposes only. Nothing herein constitutes a prediction or projection of future events or future market behavior. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

UP FOR DEBATE:

WHY A LESS FAVORABLE VIEW ON PRIVATE DEBT WHEN WE ARE MORE FAVORABLE ON CREDIT?

This quarter, while the AAC chose not to upgrade its view on high yield bonds, the consensus outlook was edging more positive. At the same time, the Committee did downgrade its view on private debt to neutral.

We can explain this apparent contradiction with four reasons.

First and foremost, it's a relative value decision as much as a decision about credit risk. After a rapid run-up in bond yields, the relative value case for private debt is less clear to us. By June this year, the yield on the Bloomberg U.S. High Yield Index, at 8.9%, had overtaken the three-year takeout yield of the Cliffwater Direct Lending Index, at 8.3%, according to the alternative investment advisor Cliffwater LLC. By early October, U.S. high yield was yielding 9.3%.

Second, as we clarify elsewhere in this *Outlook*, our view on high yield bonds does not reflect outright bullishness on the asset class, but rather an attempt to build return potential into our views as we maintain an underweight view on equities. It's worth noting that a neutral view on both high yield and private debt is more positive than the underweight views we express on most risky asset classes.

Third, while refinancing risk appears low for high yield bond issuers—only 8% of the U.S. high yield market matures before 2025—we see a more threatening "maturity wall" heading for the loan market along with portions of the private credit market.

And finally, the high yield market is generally more liquid than private debt and, perhaps less obviously, the terms and leverage structures in the standardized bond market are more homogeneous than in the broad private credit segment. In deteriorating macro environments, such as the one behind the energy sector credit dislocation in 2015 – 16, private credit strategies have tended to experience a wider dispersion of outcomes than high yield bond strategies and markets. That reinforces our argument for prioritizing higher quality in private debt, as well as opportunistic strategies that specialize in providing liquidity and structuring expertise in stressed situations, as a turn in the macro and rates environment could uncover some unpleasant shocks in more aggressive structures and strategies. At the asset-class level, however, we think it also makes a broader case for favoring public over private debt should the economy continue to slow.

Not every Committee member agreed with the consensus view—some pointed out that it is still possible to build portfolios of high-quality, well-secured private debt offering attractive yield or more—but all agreed that the decision, and the debate around it, underlined the potential advantages of managing liquid and illiquid assets in an integrated way, focusing more on their fundamental economic exposures than their liquidity profile. If we recognize that investment grade credit, high yield bonds, bank loans and private debt are all essentially credit exposures, we allow ourselves to make broader judgments on relative value that take account of all the potential trade-offs between yield, duration, security, liquidity and complexity.

Alternatives: Private Market Opportunism, Liquid Strategies to Trade Volatility

More competitive yields in non-investment grade bonds is one reason why the AAC has downgraded its view on private debt from overweight to neutral (see "Up for Debate: Why a More Favorable View on High Yield but a Less Favorable View on Private Debt?"), while maintaining its overweight view on private equity.

Here, we are taking an increasingly opportunistic view. As we discussed in detail in last quarter's *Outlook*, when we articulate our view on private equity, we have in mind an investor who is committing capital regularly as part of an ongoing pacing plan or making a new commitment to the asset class. The fact that commitments are generally put to work gradually over several years likely accounts for why, historically, some of the best performing private equity vintages were raised around the top of public market valuations--they picked up investments at subsequently more attractive levels. But we also see two specific opportunity sets beginning to develop. High-quality, mature, deleveraged assets are coming to the secondary market priced at 80 – 90% of Net Asset Value, as exit routes such as IPOs start to close and investors seek expedited liquidity. And specialist capital solutions, for companies that need to fill gaps in their capital structures as traditional sources of capital grow less accessible, are offering attractive leverage-adjusted yield opportunities.

In liquid alternatives, the AAC retains a strongly positive view on commodities when it comes to the supply side of the fundamental equation but has downgraded its overall view from very overweight to modestly overweight to reflect the recession risks building around the demand side. We also regard commodities as a potential hedge for any upside growth surprise from China over the coming months.

In hedged strategies, the focus is on trading the heightened volatility and top-down risk that we anticipate will be a prominent feature of the investment landscape over the next 12 – 18 months. Our most positive view is on global macro and market-neutral strategies, many of which we have already seen providing valuable diversification this year.

When Might It Be Time to Take Risk Again?

Faced with such an extraordinary confluence of risks and uncertainties—from central bank policy error to escalation in Ukraine, from the winter energy situation to Eurozone populism, from potential liquidity squeezes to cracks in major sovereign bonds and currencies—the long-volatility, option-like payoffs that the Committee currently seeks in liquid alternatives also inform its continuing overweight view on cash.

So, when might it be time to put cash back to work?

We have outlined some of the opportunistic investments that are beginning to develop, especially where liquidity is at a premium, as well as those areas where we see income to be harvested from high-quality assets. More broadly, however, the Committee's consensus is that patience could be a virtue in this environment; it is likely to contain a lot of falling knives, while also giving investors time to build positions once the market has reached its trough.

EQUITIES

U.S. Equities ◀▶

- The Committee maintained its underweight views on U.S. large caps and U.S. small- and mid-caps.
- Earnings estimates have barely moved, and we believe they will be revised downward meaningfully over the coming months.
- The AAC continues to favor lower beta equity exposure for defensiveness and reduced exposure to rising rates, and value over growth, with a defensive tilt via high-quality, income-oriented stocks.

Non-U.S. Developed Market Equities ◀▶

- The Committee maintained its underweight view.
- While the AAC maintains a more positive view on Japan, on the bases of its relative valuation and weaker yen, the invasion of Ukraine has introduced considerable uncertainty into the growth and inflation outlook for Europe, and earnings estimates appear over-optimistic.

Emerging Markets Equities ◀▶

- The Committee maintained its underweight view.
- There may now be value opportunities in commodity-exporting countries, and in Asia as China emerges from its recent COVID-19 lockdowns, but overall, we believe deteriorating global sentiment and U.S. dollar strength informs against seeking risk exposure in emerging markets.

FIXED INCOME

Investment Grade Fixed Income ◀▶

- The Committee maintained its overweight view.
- A rapid run-up in government bond yields, particularly in the U.S., as well as widening of credit spreads, has created meaningful value opportunities in investment grade for the first time in a long while.
- At current yields, we believe investment grade may offer some diversification during the economic slowdown.

Non-U.S. Developed Market Bonds ◀▶

- The Committee maintained its underweight view.
- Inflation and central bank hawkishness have started to push government bond yields back up, but U.S. dollar strength is making it increasingly urgent for non-U.S. central banks to catch up with the Fed on policy tightening.

High Yield Corporates ◀▶

- The Committee maintained its neutral view.
- The AAC believes that the general strength of corporate balance sheets will be supportive of credit markets as economic growth slows, but continues to favor the highest-quality issuers and short duration.
- It chose not to upgrade its view because, rather than being bullish on the asset class, that view is more to do with relative value compared with equity, and acting as a counter to our underweight view on equity: it can be seen as an attempt to retain return potential while moving up the capital structure to take account of growing challenges in the economy.

Emerging Markets Debt ▼

- The Committee downgraded its view from neutral to underweight.
- Growing political risk, and risks around global growth and the strength of the U.S. dollar, outweigh the higher yields now on offer.

REAL AND ALTERNATIVE ASSETS

Commodities ▼

- The Committee downgraded its view from a strong overweight to overweight.
- While the AAC remains strongly positive when it comes to the supply side of the fundamental equation, there are recession risks building around the demand side.
- We regard commodities as a potential hedge for any upside growth surprise from China over the coming months.

Hedge Funds ◀▶

- The Committee maintained its overweight view.
- During the ongoing economic slowdown, the AAC sees a growing role for alternative investments that have tended to exhibit uncorrelated returns, mitigate the volatility of traditional asset classes or take advantage of that volatility; and a growing role for active management, in general.
- While we think long/short equity managers may continue to struggle with whipsawing volatility and rising stock correlations, we favor strategies that are fundamentally uncorrelated (such as insurance-linked strategies) or seek to harvest a volatility premium (such as option putwrite strategies), or take advantage of global macro trends or short-term trading opportunities.

Private Equity ◀▶

- The Committee maintained its overweight view.
- While there are concerns about valuations, we believe private markets remain attractive relative to public markets, and are driving deals in high-quality, fast-growing businesses with low financial leverage; the ability to create value away from the potential volatility of the public markets may also provide some portfolio stability as the cycle matures.
- We favor businesses with strong pricing power, low fixed labor costs and limited commodity inputs, as well as real asset exposures in real estate and infrastructure.
- New commitments to vintages raised at the turn of cycles and the start of economic and market downturns have historically performed well, largely due to their investments being made while equity valuations decline.

Private Debt ▼

- The Committee downgraded its overweight view to neutral.
- We no longer see a clear relative value case for private debt over public high yield bonds; the illiquidity, homogeneity and complexity of private debt could be risky as conditions deteriorate; and refinancing risk is higher here than in the high yield bond market over the next two years.
- The AAC continues to see opportunities in special situations and capital solutions, such as providing preferred stock capital to private companies.

Private Real Estate ◀▶

- The Committee maintained its overweight view.
- The sector's inflation sensitivity is attractive as the AAC's view increasingly favors real assets over financial assets.
- We believe post-pandemic growth dynamics will continue to support key sectors such as data centers, warehouses, industrial and multi-family residential.
- Rising rates and a deteriorating macro environment have soured investor sentiment and may be opening up value opportunities.

CURRENCIES

USD ▲

- The AAC upgraded its underweight view to neutral.
- The currency is still overvalued based on purchasing power parity (PPP) metrics and real effective exchange rates.
- The U.S. is likely to see slower growth, but it has been less exposed to the energy crisis than many other countries.
- We believe the USD is overshooting and we see it going lower in the long run, but risk aversion and the energy crisis are overwhelming fundamentals, and it is still in demand as one of a shrinking group of havens.

EUR ◀▶

- The AAC maintained its neutral view.
- The euro is undervalued based on purchasing power parity (PPP) metrics, and while the Eurozone current account has deteriorated, it remains in surplus.
- The pivot to a more hawkish stance by the ECB is drawing capital flows back to Europe—and its solution for peripheral eurozone spread dislocation could enable the central bank to achieve a higher terminal interest rate, and better address the inflation threat.
- The ongoing geopolitical crisis is likely to mean persistent high energy costs for manufacturers and consumers, and general inflationary pressure.

JPY ◀▶

- The AAC maintained its overweight view.
- Both PPP and real exchange rates suggest the JPY is undervalued, market participants are very short the currency, and above-target inflation in Japan could eventually force the Bank of Japan to change its stance on yield-curve control.
- This is a cautious view, as the central bank's recent intervention to support the yen may not be enough without an adjustment to monetary policy.

GBP ◀▶

- The AAC maintained its underweight view.
- Despite being undervalued in PPP terms, particularly after recent volatility, stagflation concerns are elevated as the Bank of England is hiking rates into an economic slowdown; markets remain concerned about the U.K.'s twin deficit and reacted very badly to the incoming government's unfunded tax cuts.

CHF ▲

- The AAC upgraded its view from underweight to neutral.
- The Swiss franc is still very overvalued on PPP measures and, as one of the most attractive currencies for funding carry trades, it could weaken as global yields rise.
- That said, Switzerland has a positive current account balance and currently appears to be trading on its status as one of a shrinking group of havens, with the deteriorating geopolitical situation being a cause of recent strength.

Index Definitions

The **S&P 500 Index** consists of 500 U.S. stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

The **STOXX Europe 600 Index** is a subset of the STOXX Global 1800 Index. With a fixed number of 600 components, the Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

The **Bloomberg Global Aggregate Corporate Index** measures the performance, in USD, of corporate bonds from the Bloomberg Global Aggregate Bond Index, a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded worldwide.

The **Bloomberg Global High Yield Index** is a multi-currency measure of the performance of the global high yield debt market which brings together the Bloomberg U.S. High Yield, Pan-European High Yield, Emerging Markets Hard Currency High Yield Indices.

The **J.P. Morgan Emerging Markets Bond Index (EMBI) Global Index** measures total returns for traded hard currency debt instruments in the emerging markets.

The **Bloomberg ABS+CMBS Index** tracks asset backed securities, agency mortgage backed pass-through securities, and investment grade commercial mortgage backed securities.

The **Cliffwater Direct Lending Index** is an asset-weighted index of over 10,000 directly originated middle-market loans, as represented by the underlying assets of exchange-traded and unlisted Business Development Companies, totaling $247 billion as of June 30, 2022.

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