



NEUBERGER BERMAN

Asset Allocation Committee Outlook 2Q22

Regime Change

Against a background of structurally higher inflation and declining growth, exacerbated by Russia's invasion of Ukraine, the Asset Allocation Committee's ("AAC") views have become more risk-averse. They have also realigned with what we see as a new investment regime, signs of which have been building for many months. We think bonds may no longer be a "natural hedge" for equities, and we attach growing importance to seeking investments that can withstand or benefit from rising inflation and rates, raising important longer-term considerations for asset allocation.

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 29 years of experience.

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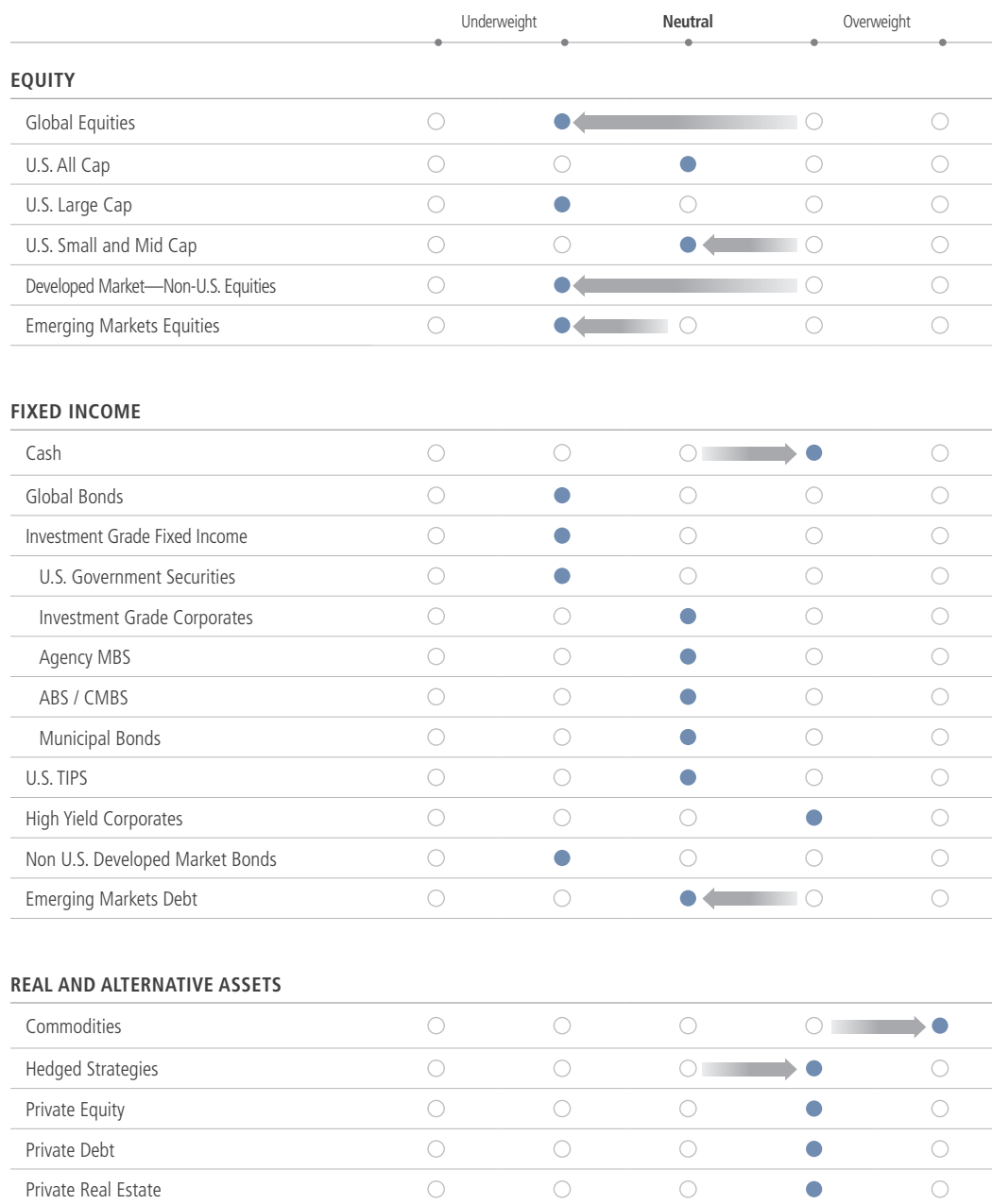
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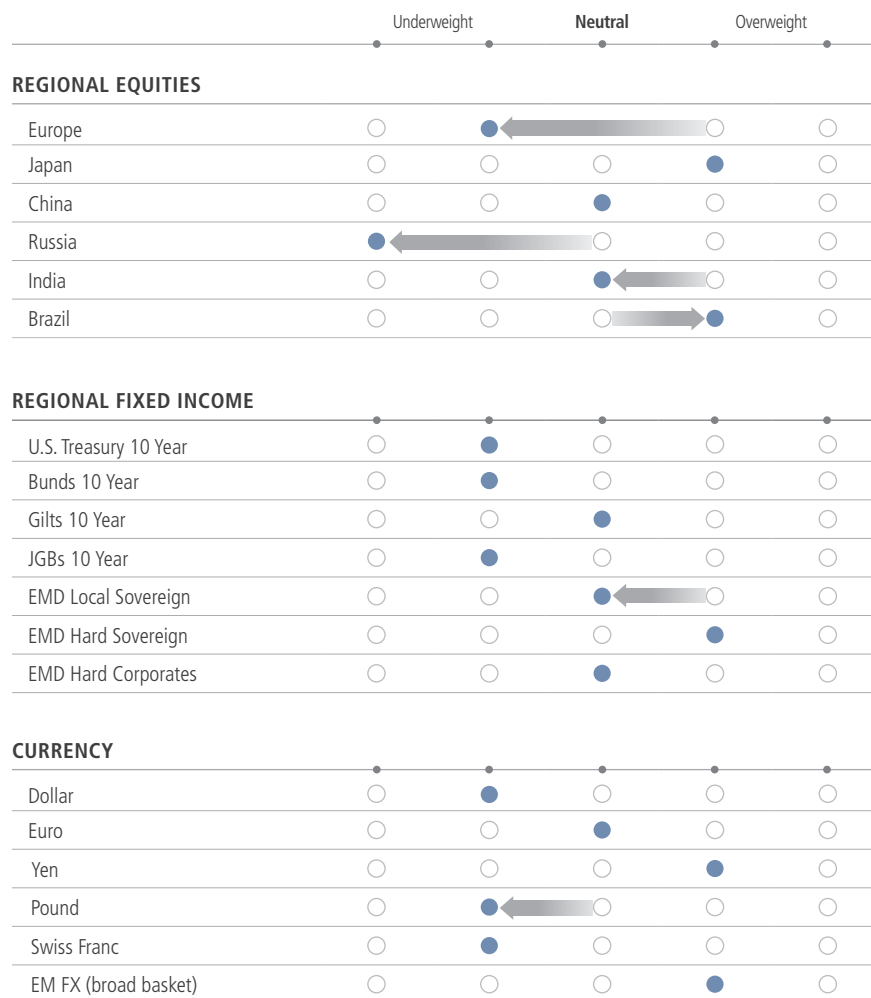
Based on 12-Month Outlook for Each Asset Class



As of 2Q 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 includes additional information regarding the Asset Allocation Committee and the views expressed.

Regional Focus

Fixed Income, Equities and Currency



“For the next two years, average implied inflation is over 3%. That’s a big deal: it’s why duration has been severely punished and why stock-bond correlations have turned positive. If that’s the new long-term regime, government bonds are only likely to be an effective hedge for risky assets in the event of a full recession. With the probability of recession rising, investors arguably need that hedge—but absent a recession, it is likely only to increase correlations and volatility within portfolios.”

Brad Tank | Chief Investment Officer—Fixed Income

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“Our latest views represent a profound reassessment compared with the past two or three decades: over the coming cycle, we think real assets could generally perform better than financial assets such as stocks and bonds, but also provide more diversification opportunity as stocks and bonds become more correlated.”

Erik L. Knutzen, CFA, CAIA

Chief Investment Officer—Multi-Asset Class

Regime Change

The map of the Asset Allocation Committee’s (“the AAC” or “the Committee”) market views is a buzz of activity this quarter. Like a sudden scrawl on a seismograph, it points to something moving or changing at a fundamental level: the return of structurally higher inflation at a time when economic growth is slowing from high COVID-recovery levels. Inflation had already become a rising concern as re-opening economies met ruptured supply chains in the aftermath of the pandemic. That dynamic is now being exacerbated by Russia’s war in Ukraine. While it is not our base case, the AAC acknowledges that the current setup raises the risk of near-term recession, either because central banks lose control of rising prices or tighten too aggressively in an attempt to arrest them. Even without recession, we think this less favorable growth-inflation mix potentially leaves investors facing a new regime that is very different from the one that has prevailed over the past two decades. In this new regime, we believe the effectiveness of long-duration, investment grade government bonds as a “natural” hedge for riskier assets is likely to fade as equity-bond correlations turn positive. By implication, we believe we may be entering an extended period during which real assets, benefitting from the inflationary headwind, could generally perform better than financial assets. This raises important long-term considerations for asset allocation.

To summarize, the AAC’s view on equities has become more risk-averse—with an underweight view on U.S. large caps and downgrades for U.S. small caps and non-U.S. markets. Reflecting that risk aversion, we see a more positive view on cash, and on active and hedged strategies that can help to dampen portfolio volatility. At the same time, however, there remains little appetite for core government bonds and other investment grade fixed income, whose long-duration interest rate exposure would normally serve as havens for the risk-averse or diversifiers against riskier assets. Instead, we now have the strongest positive view it is possible to express on commodities.

The choices on investment grade bonds and commodities reflect the new prominence of inflation, which has been building in our views for a year. But the view on equities raises additional questions. Is a recession imminent? Do we anticipate, not merely inflation, but also the materially slowing growth of stagflation? And how does all of this reflect the Committee’s views on the major changes facing asset allocators?

Risky Assets: Short Duration, Quality and Income in Public Markets, Inflation Resilience in Private Markets

Coming into 2022, we anticipated slower growth compared with the steep recovery levels of 2021 and inflation that was declining but persistent—and problematic due to its origins in tight supply. We saw downside risk to growth rising due to tightening monetary policy and financial conditions, and the fading of fiscal stimulus.

The crisis in Ukraine has exacerbated these risks, particularly by disrupting commodity markets and speeding up the ongoing trend to localize supply chains and deglobalize markets (see “Up for Debate: How Does the Ukraine Crisis Change Our Views?”). Some analysts point to the inversion of the two- and 10-year points on the U.S. Treasury curve as a sign of recession on the horizon—although we would question the predictive power of that signal, and note that other parts of the curve that have been more sensitive to the cycle in the past remain upward-sloping.

Overall, our base case over a 12-month horizon still sees positive, albeit slowing, growth—while we acknowledge some concern about rising risks and the growing potential for recession in the nearer term (see “Up for Debate: Might Central Banks Conquer Inflation by Causing Recession?”).

This deteriorating growth-inflation mix is enough to change our overall view on equities. Higher rates mean lower valuation multiples, while lower growth and rising costs eat into many businesses’ revenues and profits. For that reason, while equities are always likely to remain the core of a portfolio aiming for long-term capital growth, we think it is time to revisit the “buy-the-dip” mentality of the past two years and instead look to “fade” equity market rallies and carefully manage risk exposures.

The Committee also favors investments with lower “beta”—stocks and sectors that tend to be less volatile and less sensitive to the fluctuations of the wider equity market—as well as higher quality and higher dividend yields. This lower-beta preference applies to both value and growth stocks, large caps and small, and U.S. and non-U.S. markets.

The AAC has favored value over growth for a number of quarters, given growth stocks’ stretched valuations and greater sensitivity to rising rates. It continues to do so, but the view is becoming more balanced as the economic growth outlook softens.

We believe that growth stocks have a strategic role in portfolios, to gain exposure to long-term, through-cycle economic and investment themes, and that they can be attractive when broad economic growth is sluggish—but we think growth investors need to be especially mindful of valuations in the current cycle. Moreover, we suspect that many investors have become unwittingly overexposed to growth, given its long period of outperformance: in these cases, rebalancing toward value may still present an opportunity to lock in long-term gains while reducing sensitivity to higher rates and inflation.

While a traditional value orientation often tends to be pro-cyclical due to the prominence of industrials and financials, it can be given a defensive tilt with high-quality, income-oriented stocks, which are currently available at relatively attractive multiples.

Ultimately, slower growth is still growth. And just as that continues to support the case for value stocks, it also supports our continuing overweight view on high yield bonds. The main reason to downgrade our view on high yield would be signs of rising default risk, and we are yet to see that on the horizon. Our Fixed Income team’s stress-esting against high oil prices and zero growth suggests that corporate balance sheets are generally robust enough to prevent most issuers from getting into difficulty. Short-duration fixed income would generally suit an environment of slowing growth and rising yields, and the shock of the invasion of Ukraine has added to the attractiveness of high yield by pushing spreads out to near-recession levels.

The AAC also retains its overweight views on private equity and debt. Our Private Markets team now models its return outlooks on the expectation that there will be a recession at some point during the holding period of a business being purchased today. Just as important, the team also favors businesses with strong pricing power, low fixed labor costs and limited commodity inputs—indicating just how long-term we believe the turn to higher inflation is likely to be. Deal flow appears to be slowing from last year’s fast pace as investors anticipate declining valuations.

That said, we think private markets continue to offer specific benefits. Private equity ownership gives investors and businesses greater operational flexibility; private credit offers income, often at floating rates, backed by strong fundamentals; and private real estate and infrastructure represent attractive, inflation-responsive real-asset exposure. We also see a lot of opportunity in tailored capital solutions, such as providing preferred stock financing for private companies.

All in all, the less favorable growth-inflation mix presents a complex challenge for investments across all risky assets: maintaining a defensive stance in terms of equity market beta and credit risk, while simultaneously reducing sensitivity to rising rates and exposure to higher costs.

Government Bonds May No Longer Diversify

Growing economic risk generally leads to rising market volatility. That makes portfolio diversification a priority.

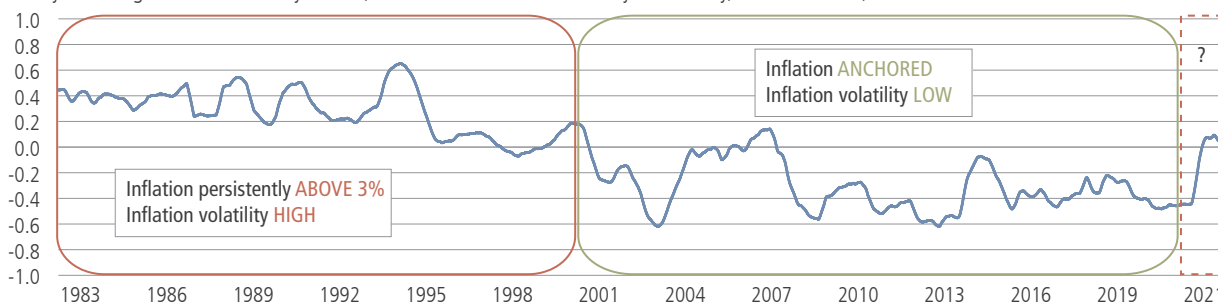
Traditionally, riskier asset exposures are balanced by allocations to “low-risk” investment grade government and corporate bonds. But can they continue to perform that function in the current environment?

When the European Central Bank (ECB) surprised markets by emphasizing its focus on inflation rather than growth in the face of the Ukraine crisis, and the Fed followed with its notably hawkish “dot plot,” long-dated U.S. Treasury yields rose, and real yields rose even faster. That kind of signal is now very difficult to interpret, particularly when closely watched points in the U.S. yield curve have been briefly inverting. Does it suggest that investors are gaining confidence that the Fed can bring inflation under control without inducing a recession? Or are investors selling long-duration, investment grade government bonds because they are no longer confident they would be an effective natural hedge for riskier assets in a slowdown? We could be entering a period of “heads, yields are up; tails, yields are up”—with bonds exhibiting much tighter correlation with riskier assets like equities.

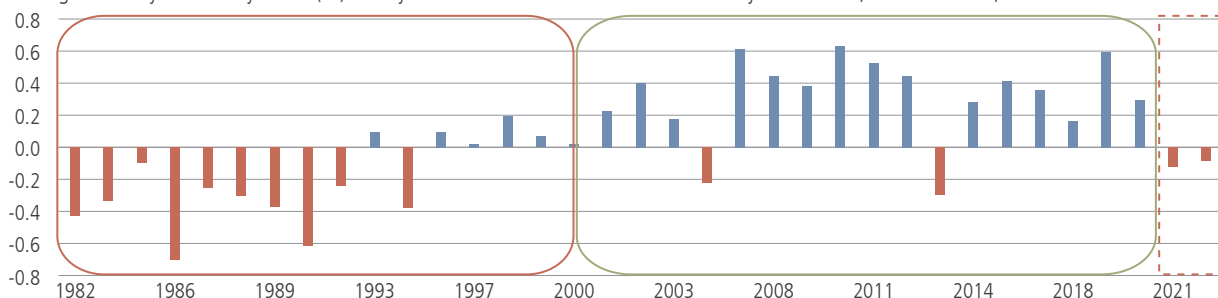
Sure enough, since the last quarter of 2021, we have begun to see equity-bond correlations rise. The history of correlations through the different inflation regimes of the past 40 years gives an indication of how this might develop. During the 2000s, when inflation was low and anchored, equity-bond correlation was almost always negative; bonds were a natural hedge for riskier assets. But during the 1980s and 90s, when inflation was persistently above 3% and more volatile, correlation was almost always positive, and sometimes high.

A NEW INFLATION REGIME COULD RAISE EQUITY-BOND CORRELATION

One-year rolling correlation of daily returns, S&P 500 Index versus U.S. 10-year Treasury, as of March 11, 2022



Average U.S. 10-year Treasury return (%) on days when the S&P 500 Index ended down by 2% or more, as of March 11, 2022



Source; Bloomberg. 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.**

Should this be confirmed as a structural regime change, it is likely to make asset allocation much more challenging. Government bonds may still provide some diversification during a full-fledged recession, and it would be risky to go without them completely—but in other circumstances, we think they are now more likely to amplify rather than dampen portfolio volatility. That raises difficult questions for asset allocation strategies such as 60/40 or Risk Parity that rely upon low or negative equity-bond correlation.

Some key views reveal the AAC's thinking about how to address this asset allocation challenge.

Cash, as a low-risk asset with ultra-short duration, and as a source of optionality during periods of high volatility, gets a more favorable view. Some Committee members see a case for extending this view out on the yield curve: they argue that when near-term inflation expectations have flattened the curve, two-year Treasuries may offer more upside than downside risk relative to the intermediate and long-term bonds that are traditionally used to dampen portfolio volatility. We have already highlighted our more positive views on high yield and private credit, reflecting our preference for credit and liquidity risk over interest rate risk.

Our view on hedged strategies has also been upgraded to an overweight—and this reflects a positive view on active management, in general, as a way to seek to take advantage of volatility and changes to investing regimes. While we think long/short equity managers may continue to struggle with whipsawing volatility, particularly as they remain generally biased toward growth stocks, we anticipate more outperformance from strategies that have the potential to thrive amid higher volatility, as well as from global macro and medium-term trend following strategies. The latter have benefited from strong trends in fixed income, currencies and, most prominently, commodities.

Real Assets Favored Over Financial Assets

It is commodities themselves, however, that receive the AAC's most eye-catching change of view: an upgrade to the highest possible overweight. It is also worth noting that the exceptions to the general downgrade of our views on equities are more positive views on certain commodity-exporting emerging markets, such as Brazil.

Commodities were already running hot before Russian invaded Ukraine, but that event drove some of the most dramatic price moves in the modern history of markets (see "Up for Debate: How Does the Ukraine Crisis Change Our Views?"). Some of these moves were temporary spikes, but we do not see a quick end to the supply-and-demand pressures that are elevating prices. The disruption of the war is likely to outlast the hostilities by many months. Shareholders' demands for spending discipline and dividend income, as well as environmental and political concerns, are preventing energy and mining companies from developing new production. And still to come, in our view, is a wave of financial demand: investors have yet to recognize the substantial positive "roll yield" in backwardated commodity futures curves, or that real assets may be the only place to find negative correlation with stocks and bonds over the coming cycle.

Commodities can be a highly volatile asset class, and most strategic asset allocations would therefore cap them at a relatively modest level. Under current conditions, the case for raising commodities allocations to those maximum levels is as strong as it is ever likely to be, in our view.

In addition to the overweight views retained on real estate and, within private equity, infrastructure assets, the view on commodities reflects a significant change from the economic and investing regime of the past two or three decades. Over the coming cycle, we think real assets could generally perform better than financial assets such as stocks and bonds, but also provide more diversification opportunity as stocks and bonds become more correlated.

This raises important long-term considerations for asset allocation.

UP FOR DEBATE:

MIGHT CENTRAL BANKS CONQUER INFLATION BY CAUSING RECESSION?

Coming into 2022, we anticipated slower growth compared with the steep recovery levels of 2021, and inflation that was declining but persistent. We do perceive growing economic risks, and are focused on two things that have the potential to tip the economy into a steep slowdown or recession.

The first is a fundamental, cyclical stalling in the economy. We do not see that risk on the horizon today. For that to materialize, we would need to see signs of sales declining, industrial production contracts going unrenewed, wages stagnating or declining and, ultimately, jobs being lost. Instead, retail sales are strong, Purchasing Managers' Indices remain robust, wage inflation is high and the employment market is tight. Millions of vacant jobs would have to be destroyed before filled jobs are lost. The spike in commodity prices looks alarming, but it is much less harmful in today's less commodity-intensive economy than the shocks of 50 years ago.

The second potential catalyst is a tightening of monetary conditions by central banks scrambling to get ahead of the inflation curve. Here there was less certainty and more debate on the Committee.

We recognize that U.S. headline inflation could potentially hit double figures before it starts declining. Some Committee members think it is possible that the Federal Reserve (Fed) will become more hawkish in its pursuit of a swift return to 2% average inflation,

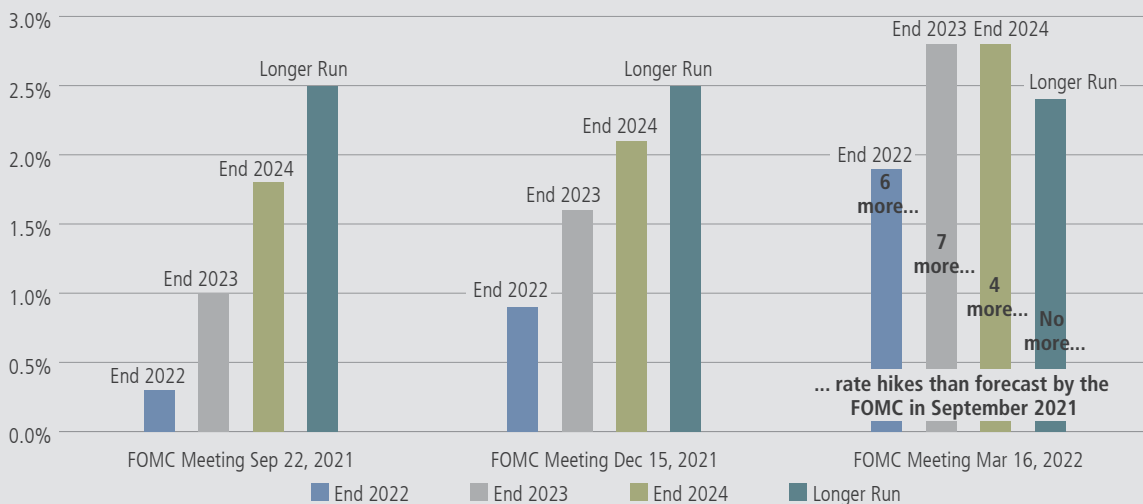
recognizing that positive real rates will be necessary to get there, which in turn implies more than the seven rate hikes it currently forecasts for 2022. That would risk bringing the cyclical slowdown forward, potentially causing a recession in the first half of 2023.

For now, however, the majority on the AAC observes that the Fed has caught up with market expectations for rate hikes, and suggests that it is now more likely to use its messaging to keep inflation expectations in check. In this scenario, once peak inflation has past, the Fed is likely to signal its willingness to tolerate a level of around 3% for a year or two as it returns to zero real rates more gradually, over an elongated cycle.

Our Fixed Income Team currently sees a low risk of near-term recession, with probabilities only starting to climb beyond the 12-month horizon. In addition, the U.S. Treasury market's response to the Fed's latest, hawkish "dot plot" appeared to be one of reassurance rather than concern: the long end of the nominal curve rose slightly, and the real yield curve rose even more, leading to a decline in breakeven inflation expectations—a sign, potentially, that investors are more confident that the Fed can bring inflation under control without inducing a substantial economic slowdown. But, as we describe in the main article and as some Committee members emphasized, there are other, credible explanations for these rising yields that reflect a far less optimistic outlook on economic growth.

THE FED HAS FRONT-LOADED THIS CYCLE'S PROJECTED RATE HIKES

Median Fed Funds Rate projections of Federal Open Market Committee (FOMC) members



Source: U.S. Federal Reserve. As of March 16, 2022. Information is as of the date indicated and subject to change without notice. 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.

UP FOR DEBATE:

HOW DOES THE UKRAINE CRISIS CHANGE OUR VIEWS?

Russia's invasion of Ukraine is arguably the biggest geopolitical shock since the September 11 attacks on New York, and perhaps the biggest since the end of the Cold War. It sent geopolitics to the top of the Asset Allocation Committee's list of current risks and concerns. But does it change the AAC's fundamental view of the economy and investment strategy? When we describe a "regime change" in the economy and markets, is it underpinned by the potential for literal regime change in Eastern Europe?

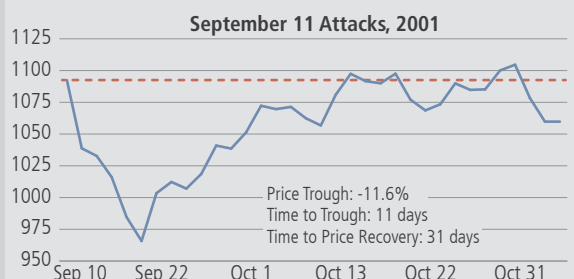
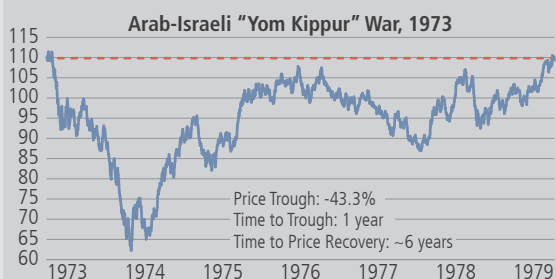
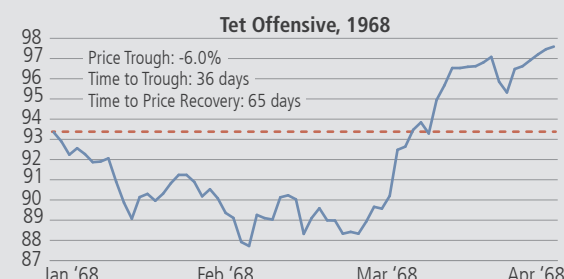
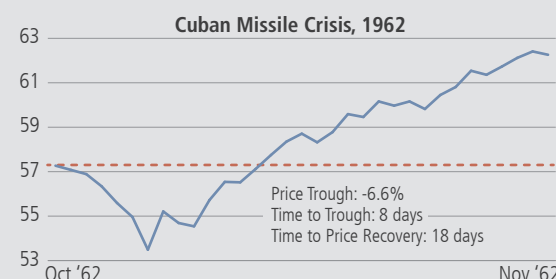
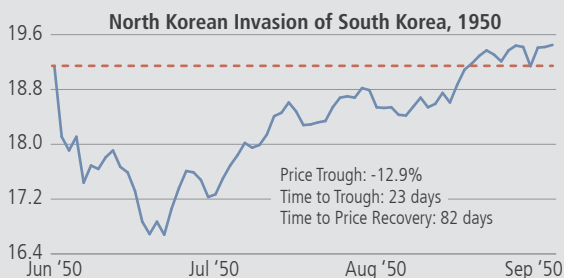
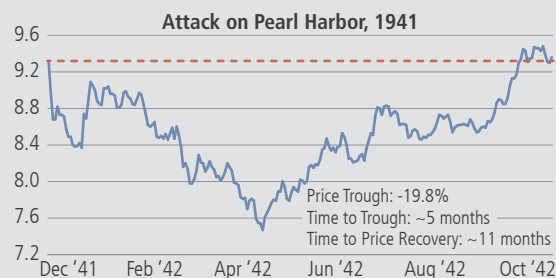
Historically, most violent geopolitical events have failed to leave a lasting impression on financial markets. The outbreak of the Korean War and the Tet Offensive during the Vietnam War caused short-term equity market sell-offs followed by quick recoveries. The S&P

500 Index was up 14% three months after the Cuban Missile Crisis and recovered from 9/11 within a month. Even the losses following the Pearl Harbor attack were erased well within a year.

When they have shown a longer-lasting negative impact, it's because they have exacerbated pre-existing economic stresses or led to policy mistakes that damaged economic activity more directly than the event itself. For example, the violent geopolitical event that arguably hit the S&P 500 Index hardest was the 1973 Arab-Israeli War. Initial losses were recovered within a week—but the Index was down 40% a year later, due to a fallout that included an oil embargo, numerous policy mistakes and extreme stagflation.

EQUITY MARKET IMPACT OF GEOPOLITICAL EVENTS, FROM PEARL HARBOR TO 9/11

S&P 500 Index price



Source: FactSet, Neuberger Berman. 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 not a guide to future results.**

Does the invasion of Ukraine fall into that category?

We think it does. Its impact is unlikely to be on the same scale, especially if the policy response is well managed, but the war exacerbates the key stress that was already building in the economy—higher inflation. While geopolitics has become the AAC’s top concern, inflation and central bank policy remain firmly in second place.

Some of these effects are immediate. Grain and fertilizer shortages could become an issue later this year, and energy prices are already biting, particularly in Europe. The International Energy Agency (IEA) warns of “the biggest supply crisis in decades.” Supply disruption is coming from official sanctions, from the “self-sanctioning” of major oil companies, trading houses, shipping firms and banks, and from war damage to infrastructure.

There is likely to be a longer-term inflationary effect as European Union (EU) countries work toward their target of independence from Russian fossil fuels. Longstanding pressure from shareholders to maintain capex discipline and increase returns on investment make other providers reluctant to ramp up production to fill the

gap. One other way to fill that gap is to speed the transition to renewable energy—but this was already an inflationary trend, and it is now complicated by Russia’s importance as an exporter of the industrial and precious metals that are critical for renewable energy infrastructure and electrification.

Moreover, the inflation pressures associated with the conflict are not confined to direct demand for food and energy commodities. Higher spending on defense, especially in Europe, now seems likely, and a return to Cold War-like tensions could speed up the ongoing trend to localize supply chains and deglobalize markets.

The invasion is visible in some localized changes to the AAC’s views this quarter. European markets are downgraded from overweight straight to an underweight view, for example. Overall, however, it is reflected in the deeper regime change, which favors real assets over financial assets as we move into an era of higher inflation and tighter equity-bond correlation. This regime change was in the cards before the invasion, and we think it will persist long after the conflict ends, but we have little doubt that it will exacerbate the underlying forces and ultimately be regarded as an important tipping point.

EQUITIES

U.S. Equities ▼

- The Committee maintained its underweight view on U.S. large caps and downgraded its view on U.S. small and mid caps from overweight to neutral.
- Growing concerns around the impact of inflation and central bank policy on the growth outlook have led to a general reduction in risk appetite, which could lead investors to favor U.S. domestically oriented companies.
- The AAC continues to favor value over growth, given stretched valuations in growth and lower exposure to rising rates in value, although the view is becoming more balanced as the growth outlook softens.
- Most importantly, the AAC favors equity income for its defensiveness and low exposure to rising rates; it believes that a value orientation should be given a defensive tilt with high-quality, income-oriented stocks, which are available at relatively attractive multiples; and it favors REITs and energy infrastructure stocks for their real-asset exposures and potentially positive exposure to inflation.

Non-U.S. Developed Market Equities ▼

- The Committee downgraded its view from overweight to underweight.
- While the AAC maintains a more positive view on Japan based on its relative valuation, the invasion of Ukraine has introduced considerable uncertainty into the growth and inflation outlook for Europe.

Emerging Markets Equities ▼

- The Committee downgraded its view from neutral to underweight.
- The invasion of Ukraine caused shocks in Eastern European and broader emerging markets.
- There may now be value opportunities in commodity-exporting countries, but these need to be balanced against ongoing struggles against the pandemic, political tail risk, and risks around global growth and the strength of the U.S. dollar.
- Some Committee members are beginning to look opportunistically at China after a year of policy-induced volatility and new monetary and fiscal stimulus—tempered by rising pandemic-management risks.

FIXED INCOME

Investment Grade Fixed Income ◀▶

- The Committee maintained its underweight view.
- Inflation and central bank hawkishness have started to push government bond yields back up, but there remains some way to go before they present attractive valuations or reliable diversification.
- Rising yields in the face of growing risks to economic growth may be a signal that investors are becoming more fundamentally skeptical of government bonds' hedging qualities: the AAC itself has upgraded its view on cash to reflect its risk concerns, rather than upgrading its view on government bonds.

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 there remains some way to go before they present attractive valuations.
- We see more attractive value in high yield and other areas of the credit market.

High Yield Corporates ◀▶

- The Committee maintained its overweight view.
- The invasion of Ukraine has widened spreads to near-recession levels, creating an attractive value opportunity with absolute yields not seen for several years.
- The AAC believes that the general strength of corporate balance sheets will be supportive of credit markets as economic growth slows.

Emerging Markets Debt ▼

- The Committee downgraded its view from overweight to neutral.
- The invasion of Ukraine effectively made Russian securities uninvestable, as well as causing shocks in Eastern European and broader emerging markets.
- There may now be value opportunities in commodity-exporting countries, but these need to be balanced against ongoing struggles against the pandemic, political tail risk, and risks around global growth and the strength of the U.S. dollar.

REAL AND ALTERNATIVE ASSETS

Commodities ▲

- The Committee upgraded its view from overweight to strong overweight.
- Commodities were already one of the few reliable ways to hedge against the potential for persistent cost-push, supply-side inflation pressures.
- The invasion of Ukraine and consequent sanctions against Russia are already causing a substantial supply crunch in energy markets, and threaten higher food prices later in the year.
- It also has the potential to exacerbate longer-term commodity market imbalances, given Europe's plans to become independent of Russian fossil fuels, the importance of Russia as a provider of essential commodities for the net-zero and electrification transition, Europe's fiscal and military spending response, and added impetus to the ongoing trend to de-globalize and localize supply chains.

Hedge Funds ▲

- The Committee upgraded its view from neutral to overweight.
- With equity and bond valuations stretched and at risk from rising real rates, we see 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, we anticipate more outperformance from global macro and medium-term trend-following strategies, which have seen a turnaround due to strong trends in fixed income, currencies and commodities.
- The Committee maintains a positive view on equity index put writing, which has tended to perform well during periods of elevated volatility.

Private Equity ◀▶

- The Committee maintained its overweight view.
- While there are concerns about valuations, they remain attractive relative to public markets, and are driving deals in high-quality, fast-growing businesses with very 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.

Private Debt ◀▶

- The Committee maintained its overweight view.
- We believe credit selection is important in a market that is increasingly borrower-friendly, with full valuations and (already loose) covenants loosening further; that said, valuations remain attractive relative to public-market high yield credit, and floating rates may provide a buffer against tightening monetary policy.

Private Real Estate ◀▶

- The Committee maintained its overweight view.
- The sector's inflation sensitivity is attractive as the AAC increasingly turns to 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.

CURRENCIES

USD ◀▶

- The AAC maintained its underweight view.
- The currency is still overvalued based on purchasing power parity (PPP) metrics and faces headwinds from the U.S.'s twin deficits, and historically it has tended to peak around the first rate hike in a cycle.
- Risks to the view are the potential for higher U.S. growth expectations relative to the rest of the world, in the light of the Ukraine crisis, and further Fed hawkishness.

EUR ◀▶

- The AAC maintained its neutral view.
- The euro is undervalued based on purchasing power parity (PPP) metrics, benefits from a large current account surplus, and could benefit from a fiscal impulse from the EU Recovery Fund later in the year.
- The pivot to a more hawkish stance by the ECB is likely to draw capital flows back to Europe—although the Fed is matching that rhetoric for the time being, and the Ukraine crisis has created a less favorable growth and inflation outlook for the region.

JPY ◀▶

- The AAC maintained its overweight view.
- Both PPP and real exchange rates suggest the JPY is undervalued, market participants are now very short the currency, and hedged foreign investments are at their most attractive levels in years for JPY-based investors.
- The Ukraine crisis may continue to generate haven demand for the currency, but higher gas prices and limited storage present a potential risk to Japan's economy.

GBP ▼

- The AAC downgraded its view from neutral to underweight.
- Higher gas prices and limited storage present a potential risk to the UK economy, raising stagflation concerns, and both fiscal and monetary policy is tightening despite a domestic slowdown and cost-of-living squeeze for consumers.
- The view remains marginal, as market participants are now short GBP, PPP suggests the currency is undervalued and interest rate differentials remain supportive.

CHF ◀▶

- The AAC maintained its underweight view.
- The Swiss franc is still very overvalued on PPP measures, and market participants remain very long in their positioning.
- Risks to the view include the potential haven demand generated by the Ukraine crisis and Fed hawkishness, and Switzerland's large current account surplus.

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