# Key themes and their investment implications for Q3 2022

| | Asset Allocation | Equities | Fixed income | Private markets | Real estate |
|---|---|---|---|---|---|
| **Hard or crash landing** | ▪ Defensively positioned, underweight equities and credit. Hawkish CBs and stubbornly high inflation suggests further volatility is probable.<br>▪ Preference for government bonds vs credit in anticipation of focus shifting to growth downturn and to offset credit UW.<br>▪ Overweight USD on rate differentials and safe-haven characteristics. OW euro vs sterling also on rate differentials. | ▪ Equity volatility likely to stay high at least until inflation begins to moderate and CBs dial down the hawkishness. Selected opportunities for stock pickers amongst oversold names.<br>▪ Rising real yields have led to rotation to value from growth. Investors may benefit from value exposure, especially if inflation remains elevated. Value continues to be relatively cheap | ▪ Growing risk of a hard landing not yet fully priced into fixed income markets. We believe that capital preservation in Q3 will be essential. Further CB tightening could move spreads wider.<br>▪ We believe that CBs are unlikely to tighten as much as market currently expects –providing opportunities in US and EU core government bonds.<br>▪ Prefer IG over HY. We consider that Euro IG is attractively valued and has repriced too far. | ▪ A number of pressures, ranging from company transportation networks, supply chains and inventory build, are likely to become fully visible in earnings over the next 12-18 months. Could see an abrupt slowdown, but severity is hard to gauge.<br>▪ Expect risks at the lowest end of the ratings scale (CCC) to increase; however, default rates should remain below previous peaks. | ▪ There tends to be a long lag between changes in interest rates and real estate values.<br>▪ Low transaction volumes this year reflect a nervous investment market. There appears to be a 'sellers' strike' underway, as buyers digest a rapidly rising cost of debt.<br>▪ Index-linked leases that are more prominent in Continental Europe offer some inflation protection. These will drive rents and support values to some degree as yields shift outwards |
| **China recovery** | ▪ Constructive view on China equities, given improving fundamentals and attractive valuation and technical factors.<br>▪ Preference for EM equities vs Europe, where we believe recession remains likely. China's emergence from lockdown supportive of EM. | ▪ Positive long-term case for Chinese equities as valuations are around historical lows.<br>▪ Some caution in the short term as much depends on Covid developments and level of stimulus.<br>▪ Japan equities could provide a DM diversification option with relatively high exposure to China's recovery. Exporters are attractive after a sharp fall in the yen. | ▪ On a real yield basis, China more attractive relative to other markets; Neutral on CGBs short term but CGB yields could rise in 2023 on more fiscal support and limited monetary easing.<br>▪ Asian HY could be attractive for risk takers but it will continue to be a bumpy road. | | |
| **The global consumer** | ▪ Consumer squeeze will challenge growth supporting underweight to risk assets.<br>▪ Cost of living challenges and the rising cost of capital are major headwinds; the US consumer is showing cracks, which we are monitoring. | ▪ We are focused on companies that offer margin protection, given inflationary pressures.<br>▪ Balance sheets are still healthy and credit card spend remains strong, but US consumers are starting to feel the pressure, with savings rates declining and real wages turning negative. | ▪ Expectation is for a sudden deterioration in labour markets, putting additional pressure on consumer spending. Credit markets still underprice this risk, especially in US high yield. | ▪ Not yet clear where the consumer's breaking point will be. Historical assumptions on companies' cost pass through ability may not hold given double digit inflation. Borrowers may need to find alternative levers to pull.<br>▪ Evidence of food retail consumers trading down.<br>▪ In the near term, strong pent-up demand for some Covid impacted services | ▪ Weak consumer spending is likely to dampen demand for high street and shopping centre retail space, limiting rental growth from recently re-based rents.<br>▪ There is increased risk of a slowdown in logistics demand as a result of an overall reduction in sales volumes and a return to multi-channel sales. |

## Important Information