Good news, yet markets miss the point

March 2023

CUSTOMISED SOLUTIONS | GLOBAL BALANCED RISK CONTROL TEAM | PATH | 3 March 2023

After a very strong start to the year, most major developed markets lost momentum in February. Recession risks appear to be receding, given a resilient labour market. However, a closer look shows job data is cooling. For now, we believe inflation will continue to fall in the first half of 2023 and even into the second half of the year. While we remain concerned that inflation could at some point become unanchored, this appears to be a risk for the second half of the year.

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Labour market dynamics: look closer at the data

Strong jobs and inflation prints have led markets to expect a hawkish Federal Reserve in the short term. However, as we dig deeper into the data, it appears that the remarkable resilience of the labour market may have been temporarily exaggerated. The Job Openings and Labor Turnover Survey (JOLTS) data[1], has a month's lag and may not always indicate the real-time trend. Higher frequency data suggests that job openings might be starting to fall and can thereby change the narrative. Markets appear to be using lagged labour market data and are pricing in a hawkish Fed. If, in fact, jobs data were cooling this would be yet another dramatic twist and investors would likely have to reverse course. This rebalancing of the labour market is likely to be key for lower wage growth and ultimately inflation.

Investment Implications

The sharp sell-off in assets in February is based on a market narrative of rising inflation and tighter monetary policy. However, if this trend reverses, we expect markets to rally. Stabilising inflation and policy risks may

Notes:
[1] Monthly survey published by the U.S. Bureau of Labour Statistics (BLS), a general indicator of jobs data including job openings, hires and separations.

be supportive of equity markets as the high cash in money markets is expected to return once the narrative changes. Bearing this in mind, we continued to add further risk in our portfolios. We made several tactical changes over the month, which we have outlined below. We also added put options to portfolios prior to the US CPI data released mid-month to mitigate the downside, even while generally maintaining a risk-on positioning.

This is reflected in the tactical changes we made over February:

World Growth Equities
We moved from underweight to neutral World Growth equities, as macro conditions can support growth equities over a tactical time horizon. Valuations remain a headwind since the premium over value stocks or blend benchmarks remains wide compared with pre-Covid trends.

US Health Care Equities
We moved from overweight to neutral US Health Care equities. We initiated an overweight in December as a defensive sector working to a lower beta. However, our increase in risk means this is no longer required. In addition, the sector is experiencing sizeable earnings downgrades due to margin pressure and is still over owned after strong fund inflows in 2022.

EuropeanB Equities
We continued to add to our overweight to European bank equities, as recession risks recede for now, especially in Europe. The sector is favourable, as it continues to benefit from higher eurozone rates, boosting net interest margins and benign asset quality trends.

Italian Equities (FTSE MIB)
We initiated an overweight to the FTSE MIB Index as Italian assets can benefit from the more coordinated fiscal and monetary policy in the EU, which reduces fragmentation and country-specific risks. The index offers exposure to sectors which look undervalued, or which are set to perform well the in current environment.

EUR High Yield
We further added to our existing overweight position as macro headwinds for Europe have eased considerably over the past weeks, which should allow spreads to remain relatively stable and grind tighter.

Short-Dated Mexican Bonds
For portfolios which permit, we added to our existing overweight to short-dated Mexican bonds. The bonds offer attractive carry, while we see the potential for range bound FX upside in 2023 relative to the US dollar.

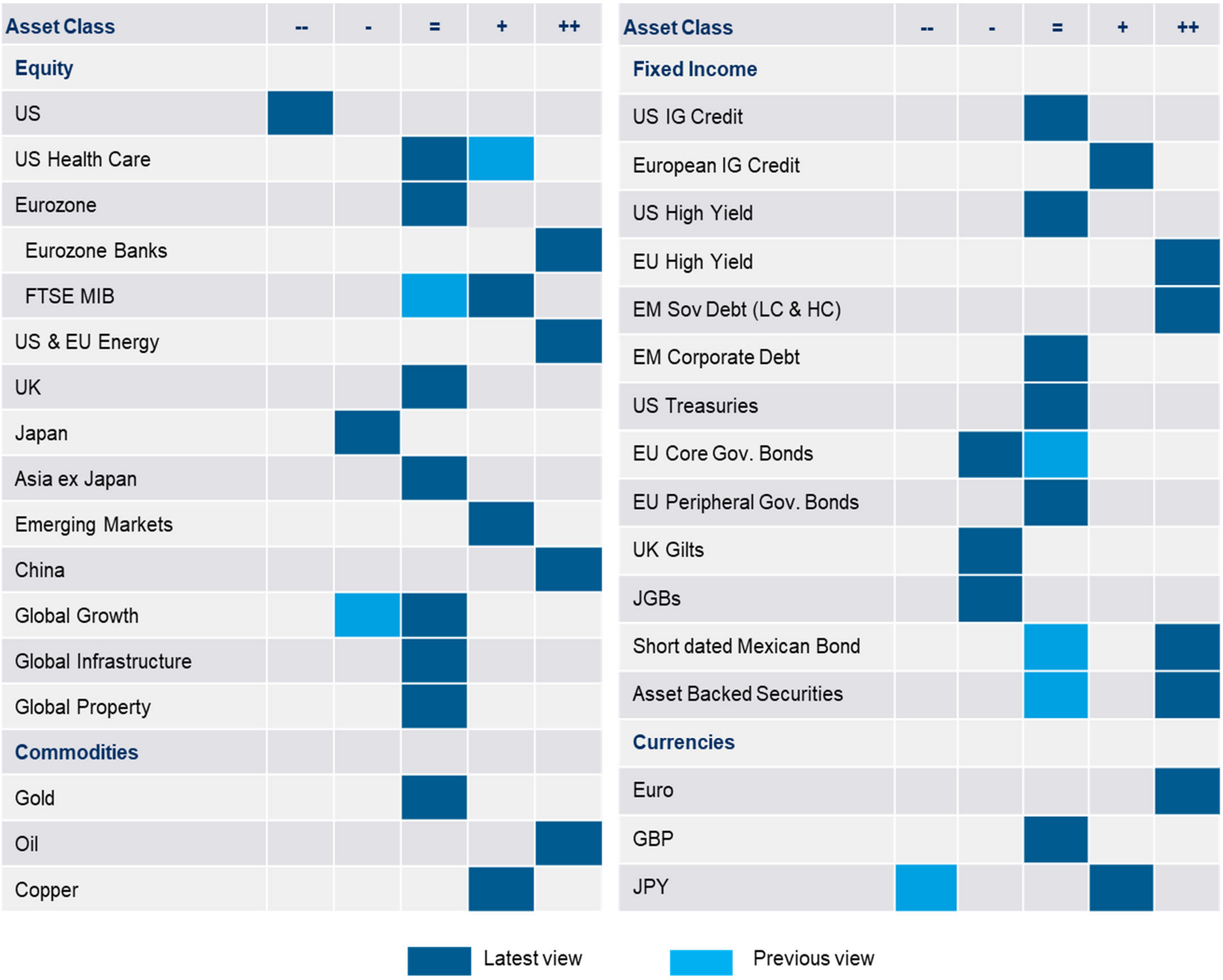
Global Asset Backed Securities (ABS)
We initiated an overweight to Global ABS during the month and further added to it before month end due to conviction in the asset class. Housing market fundamentals are more resilient owing to tight supply and

low inventories, while mortgage underwriting standards and borrower quality are much better than during the Global Financial Crisis cycle.

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results. See Disclosure section for index definitions.**

Tactical Positioning

We have provided our tactical views below:



Source: MSIM GBaR team. Previous view is as of 31 January 2023 and current view is as of 28 February 2023. For informational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy. The tactical views expressed above are a broad reflection of our team's views and implementations, expressed for client communication purposes. The information herein does not contend to address the financial objectives, situation or specific needs of any individual investor. The signals represent the

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JOLTS (Job Openings and Labor Turnover Survey): This monthly survey, conducted by the Bureau of Labor Statistics, collects data on job openings, hires and separations from some 16,000 US businesses. It covers all nonagricultural industries in the public and private sectors for the 50 states and the District of Columbia.

FTSE (MIB): The FTSE MIB is a benchmark index for the Italian equity markets. Capturing approximately 80% of the domestic market capitalisation, the index is comprised of highly liquid companies in Italy.

Consumer Price Index (CPI): The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. The CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.

Asset Backed Securities (ABS): a type of financial investment that is collateralized by an underlying pool of assets—usually ones that generate a cash flow from debt.

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