

2023 Mid-Year Investment Outlook

Slow-motion slowdown



Key takeaways

- While recession isn't inevitable, the U.S. economy is on track to see slower growth and lower inflation over the rest of 2023 and into 2024.
- A divergent global economic path seems likely with the U.S. slowing and the eurozone, China and broader Asia accelerating, suggesting further U.S. dollar weakness.
- Given recent economic data and Federal Reserve (Fed) commentary, markets have priced out most of the rate cuts later this year pushing bond yields higher. The current outlook suggests investors can benefit from falling rates by increasing duration and embracing high-quality corporate credit.
- Equity markets are off to a better start in 2023, but performance has been driven entirely by multiple expansion; the outlook for monetary policy and the potential for recession will be key.
- Favorable absolute and relative valuations, a weaker U.S. dollar and upside to international earnings expectations point to international equity outperformance versus the U.S.
- The onset of higher interest rates and reset in equity valuations last year have created public market opportunities, but we still see room for alternatives to enhance returns, generate income and provide diversification.
- ESG investing should be supported in the long run by policy commitments that should spur private sector innovation and scale.
- With significant changes to the macroeconomic backdrop and investing landscape, active management with prudent security selection and a bias toward quality will be the best approach to asset allocation.

U.S. economy: Slow-motion slowdown

Across the U.S. economy, the outlook is for slower growth – slower growth in demand, in jobs, in profits and in inflation. Recession is by no means certain. However, a slow-growing economy is rather like a slow-moving bicycle – the slower it moves, the easier it is to topple over. And so, in the summer of 2023, there is a significant risk of recession starting before the end of the year. If recession occurs, it is likely to be much milder than the last two mega-recessions of 2008-2009 and 2020, both in terms of output loss and unemployment. This also suggests only a sluggish recovery from such a recession. However, it also should mean a continued fall in inflation as the U.S. economy returns to a path of slow growth, low unemployment, low inflation and low interest rates – an unexciting environment for American workers and consumers but a supportive one for financial assets.

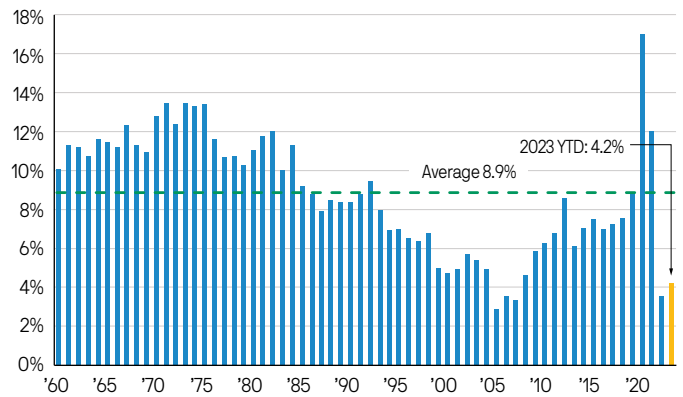
Our economic outlook starts with economic growth, which, in turn, depends on the components of demand, namely, consumer spending, homebuilding, business fixed investment, inventories, international trade and government spending.

The end of government pandemic assistance is still hurting consumer spending. Federal aid allowed consumers to boost spending to unsustainable levels in 2020 and 2021, and since then consumers have tried to maintain this spending by eating into savings and increasing debt. As shown in **Exhibit 1**, the personal saving rate (which is the difference between disposable income and personal outlays, expressed as a percent of disposable income) averaged 7.6% in the five years before the pandemic but, after a roller coaster ride over the past three years, has been just 4.2% in the first four months of 2023. Saving will likely increase over the next few years, which will be a drag on consumer spending, as will the resumption of repayments on federal student loans.

That being said, consumer spending will be helped by pent-up demand for autos. Light-vehicle sales averaged 17.2 million units from 2015 to 2019 but just 14.4 million units over the past three years, as the pandemic suppressed both demand and supply. Improved supply has now boosted light-vehicle sales to a 15.6 million unit pace so far in the second quarter and, if sales build on this pace for the rest of the year and into 2024, it may be enough to keep real consumer spending growing, even with weakness elsewhere.

Consumer spending should grow more slowly to return saving to its pre-pandemic trend

Exhibit 1: Personal savings as a % of disposable personal income, annual



Source: BEA, Federal Reserve, J.P. Morgan Asset Management. Guide to the Markets – U.S. Data are as of June 5, 2023.

Homebuilding appears to be stabilizing at a low level. Single-family building permits fell by 35% in the year ended in the first quarter of 2023. However, with supply tight and mortgage rates steady at close to 7.0%, there are signs that the worst of the decline is behind us. Meanwhile, multi-family homebuilding remains strong, reflecting the impact of high rents and a very tight supply of rental units.

Business fixed investment appears to be the most vulnerable area of demand. Layoffs in the tech sector could reduce the growth in R&D, while growing lender caution could restrain spending on plant and equipment. In addition, high vacancy rates in the office and retail sectors should weigh on construction spending, although this could be somewhat alleviated by better growth in warehousing and data centers.

Inventories rebounded very sharply throughout 2022 as businesses replenished stocks depleted by the pandemic. However, this process now appears to have come to an end with real inventories only growing slightly in the first quarter. For the rest of this year, inventories should see modest growth, adding to real GDP growth. However, pessimism among businesses, the growth of online shopping and higher interest costs should all constrain inventory growth going forward, limiting its impact on GDP gains.

International trade added to real GDP growth over the past four quarters. However, going forward, it should be a mild drag, reflecting the lagged impact of a too-high dollar. That being said, the global economy appears to be seeing a pickup in momentum in the first half of 2023, while the trade-weighted dollar has now fallen by 9% from its peak. This should limit the damage to the economy from deteriorating trade going forward.

Finally, government spending should be a mild positive for growth going forward. Federal government spending will continue to be restrained by the divided government in Washington. However, state finances remain in relatively healthy condition and state and local spending should expand in line with employment as governments seek to fill currently vacant roles.

Adding up the pieces of demand, it is easy to predict a further mild slowdown in real GDP growth. However, it is hard to forecast a sharp recession without some other, as yet unrevealed, shock.

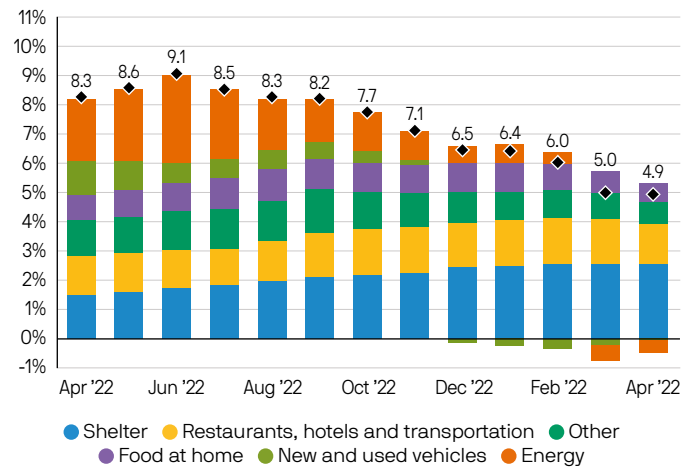
Employment growth also appears to be slowly diminishing, despite a mixed May jobs report. The unemployment rate, rising from 3.4% in April to 3.7% in May, suggests some slowdown in momentum. However, payroll job growth remains resilient, averaging over 300,000 jobs per month so far this year. That being said, the last few months have seen a steady increase in unemployment claims from very low levels, a decline in job openings from very high levels and many other indicators pointing to slower job growth going forward. We expect this to continue in the months ahead as businesses grow more cautious and labor supply continues to be a problem. If real GDP growth stays soft over the spring and summer, payroll job growth could well slip into negative territory by sometime in the fall.

Some of this, of course, depends on corporate profits, and first quarter earnings have been surprisingly strong, all things considered. S&P 500 operating earnings per share, at roughly USD 52.90, were up 7.2% year-over-year in the first quarter. We expect year-over-year gains to fade over the next few quarters as the economy sees slower growth and lower inflation. However, the ability of U.S. corporations to produce this kind of earnings growth in a difficult climate bodes well for profit gains in the years ahead.

And finally there is the issue of inflation. As is shown in **Exhibit 2**, headline consumer price index (CPI) inflation came in at 4.9% year-over-year in April, unchanged from March but down from 9.1% last June. We expect this to drop below 3.5% by this June and then move sideways or slightly upwards for the rest of the year before resuming a decline to 2.0% or lower by the end of 2024. Normalizing commodity markets, diminished supply chain disruptions, an increasing supply of apartments and moderate wage gains all point to declining inflation. Numbers published over the next few months should allow many, including Federal Reserve officials, to acknowledge this.

After a two-year surge, inflation is now trending down

Exhibit 2: Contribution to y/y % change in CPI, not seasonally adjusted



Source: Bureau of Labor Statistics, FactSet, J.P. Morgan Asset Management. Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owners' equivalent rent and rent of primary residence; "Other" primarily reflects household furnishings, apparel, education and communication services, medical care services and other personal services. Guide to the Markets – U.S. Data are as of June 5, 2023.

There are, of course, risks that could push the economy into recession or revive inflation. However, as of today, we are in a slow-motion slowdown rather than recession and this environment could yet be supportive of financial markets.

International economy: Diverging upwards as the U.S. trends downwards

As 2022 ended, the global economy was losing speed, with only 32% of countries registering a manufacturing PMI over 50 (signaling accelerating momentum). The question for 2023 was how much further momentum would fall: a recession in Europe was a foregone conclusion due to the energy price shock and a slow China recovery was expected due to a slow unwind of the “Zero COVID policy” (ZCP) shock. Today, instead of slowing down, the global economy has picked up speed, with 40% of countries registering a manufacturing PMI over 50 and the global services PMI at an 18-month high.

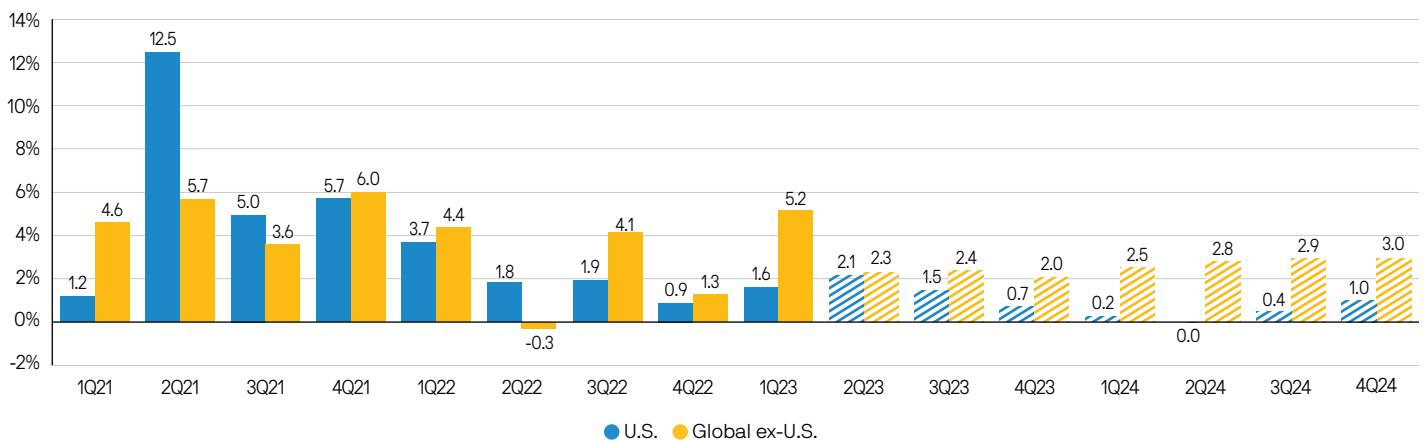
What changed? Last year’s two big negative shocks have turned positive. In the eurozone, the consensus recession was very shallow. Surging energy prices turned into plummeting energy prices, with European natural gas prices 55% below levels before the war in Ukraine. Manufacturing is now stabilizing, and services are seeing a boost from consumption as headline inflation falls rapidly (10.6% in October to 6.1% in May). Looking ahead, the eurozone’s April composite PMI of 52.8 in May suggests growth closer to 2%. Record low unemployment and rising wages provide a cushion to the lagged impact of 375 basis points of tightening by the European Central Bank (ECB). In China, the elimination

of ZCP occurred rapidly, and the reopening impulse is powerful. This is a unique Chinese recovery: focused on the consumption rebound of 15% of the world’s population after three years of below-average spending. Travel and leisure spending has bounced back strongly – now the question is whether other services and goods spending will pick up as well. A recovery in private business and consumer confidence is key. If not, Chinese policymakers have room for more stimulus with headline inflation at only 0.1% in April. China’s recovery is a powerful tailwind to its major trading partners (and tourist destinations) in Europe and Asia. As a result, a divergent global economic path seems likely with the U.S. slowing and the eurozone, China and broader Asia accelerating (**Exhibit 3**).

A key place to look for this impact is the U.S. dollar, which has weakened 9% since late September; however, this follows an 11-year cycle of appreciation (**Exhibit 4**). Four factors suggest a continued downtrend in the dollar: a still-expensive starting point versus fair value, improving growth momentum overseas, shrinking interest rate differentials versus the rest of the world and flows returning to non-U.S. markets. This should provide a relief for central bankers’ fights against inflation and for U.S. dollar-based investors’ international returns.

We expect divergent economic momentum ahead, with U.S. slowing and rest of world accelerating

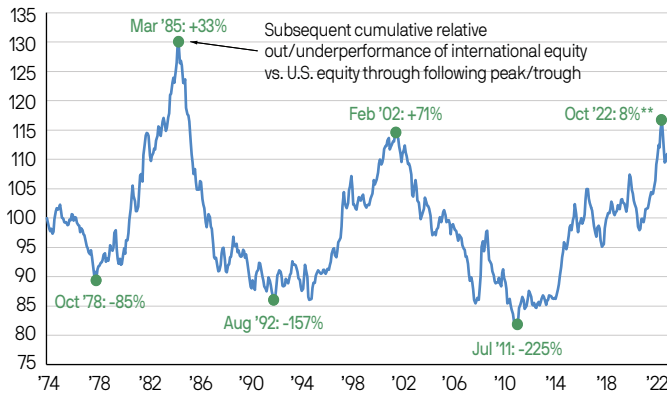
Exhibit 3: Real GDP growth, year-over-year % change



Source: FactSet, J.P. Morgan Asset Management. Shaded figures represent J.P. Morgan Global Economic Research estimates for GDP growth. Data are as of June 5, 2023.

The U.S. dollar downcycle seems likely to continue, suggesting international equity outperformance

Exhibit 4: Real broad effective exchange rate, MSCI World ex-U.S. vs. S&P 500*



Source: J.P. Morgan Global Economic Research, MSCI, J.P. Morgan Asset Management. *U.S. dollar is the J.P. Morgan Global Economic Research real broad effective exchange rate (CPI) indexed to 100 in 1974. Relative international equity returns are cumulative, total returns in U.S. dollars and are calculated as MSCI World ex.-U.S. minus S&P 500 for each period of U.S. dollar peak/trough. **Data since Oct. 2022 represents the relative outperformance to the latest month end. Past performance is not a reliable indicator of current and future results. Guide to the Markets – U.S. Data are as of June 5, 2023.

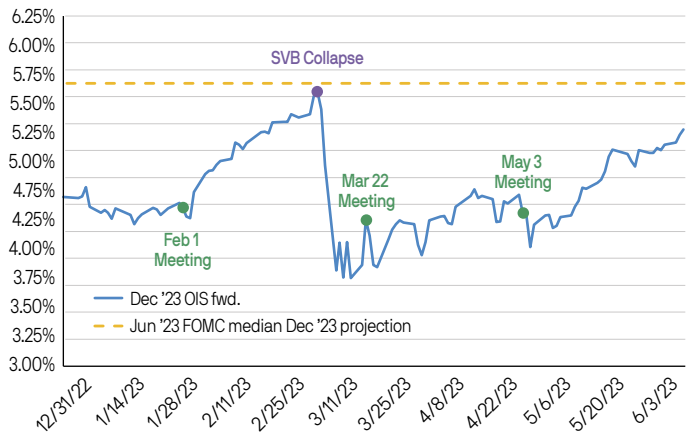
Fixed income: A mid-year hawkish skip

At its June meeting, the Federal Open Market Committee (FOMC) voted to leave the Federal funds rate unchanged at a target range of 5.00%-5.25%. However, refreshed interest rate projections via the “dot” plot suggest this is simply a mid-year skip, rather than a prolonged pause. In fact, the median committee member now anticipates two more rate increases are likely before year-end followed by rate cuts beginning some time in 2024. Given changes in monetary policy are among the most important drivers of stock and bond returns – as evidenced by the year-to-date movement in interest rates and equity market valuations – an important question for investors over the balance of the year is how hawkish the committee might remain given inflation is slowing, yet still running above target.

Exhibit 5 shows the evolution of the expected fed funds rate at the December 2023 meeting since the start of the year. Notably, the June FOMC meeting made it clear that the committee still needs more compelling evidence that inflation is under control and could very well tighten at least once more this summer. As a result, recent market action has removed most of the cuts priced in the second half of 2023 and expected year-end policy rates are near where they were prior to the collapse of Silicon Valley Bank in early March.

Markets are now in-line with hawkish Fed expectations

Exhibit 5: Expected Fed funds rate at the December 2023 policy meeting date, OIS forwards vs. median June 2023 median dot plot forecast



Source: Bloomberg, J.P. Morgan Asset Management. Data are as of June 14, 2023.

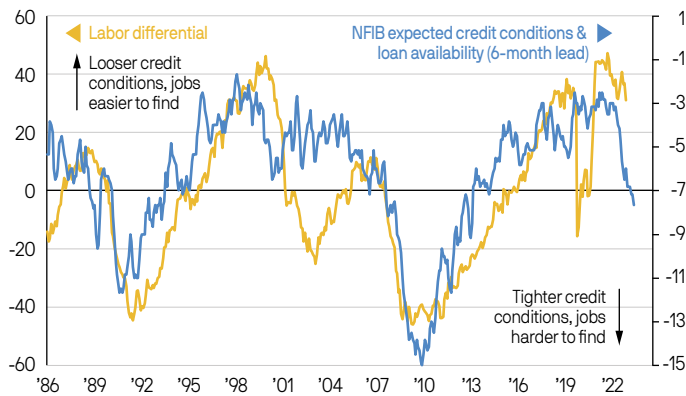
At the current juncture, while forward looking indicators suggest year-over-year inflation will continue to decelerate and the U.S. economy could experience, at best, a slowdown or, at worst, an outright recession over the next few quarters supportive of a pause, the committee is biased to tighten further.

Looking ahead, while the Fed has acknowledged there may need to be some pain in the real economy to return inflation to 2%, stresses emanating from the banking sector may force the Fed’s hand to cut rates sooner than it expects as tighter lending conditions act as a drag on businesses and consumers. Roughly 52% of the private workforce is employed by companies with 500 or fewer workers. Many businesses of this size bank at local and regional financial institutions. Given the availability of loans has become more restrictive and securing a loan has become more costly, when businesses look to access credit, it is likely they will be met with a painful reality of having to lay off staff and/or struggle to rebuild inventory.

As shown in **Exhibit 6**, tighter credit conditions tend to lead weakness in labor markets. Moreover, banks may still be pressured by deposit outflows given more attractive rates elsewhere; unrealized losses on bond holdings given higher rates and potential write-downs on commercial real estate holdings could continue to pressure lending capacity.

Tighter credit conditions tend to lead to weakness in labor markets

Exhibit 6: Conference Board labor differential vs. NFIB small business expected credit conditions & loan availability (3-month moving average), seasonally adjusted



Source: Bloomberg, The Conference Board, National Federation of Independent Business, J.P. Morgan Asset Management. Labor differential is a subindex in the conference board consumer confidence index. This indicator takes the percentage of consumers who say jobs are plentiful and subtracts the percent that says jobs are hard to find. Data are as of June 5, 2023.

Investment implications

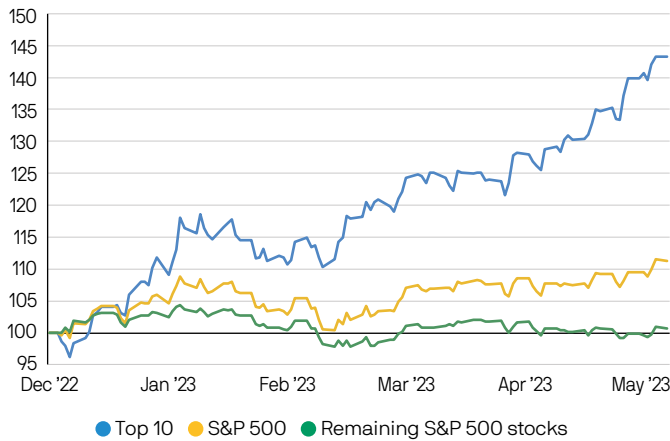
- Even though Fed commentary remains hawkish, the backdrop of slowing growth and falling inflation should bias long-term yields lower through the end of the year.
- While we don’t expect a collapse in the banking system, we recognize that stresses on regional banks are unlikely to subside until the Fed starts cutting rates. Moreover, tighter lending conditions are likely to contribute to labor market weakness, a rise in default activity and slowing private fixed investment.
- Investors should look to embrace high-quality duration as core bonds have historically performed well near the end of a Fed tightening cycle and subsequent reduction in policy rates.
- As the Fed potentially shifts its rhetoric in favor of lowering rates later this year, while supportive of higher equity multiples, it will likely be in response to economic weakness, a poor environment for risk assets, especially growth equities. Therefore, we continue to lean into high-quality companies with strong cash flows in portfolios.

U.S. equities: Up, up and away?

2023 has seen U.S. equities rebound from a dreadful 2022, where rising interest rates undermined the valuation of effectively every asset across the capital markets. However, while 2023’s performance has been better, it has been entirely driven by valuation expansion on the back of lower interest rates, with the top 10 companies in the S&P 500 accounting for 11.09 percentage points of the 11.31% price return. As we think about the back half of the year, two variables are in focus – the outlook for monetary policy and the potential for recession.

The largest names in the S&P 500 have dominated the index this year

Exhibit 7: YTD, indexed to 100, price return



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Top 10 stocks include: AAPL, MSFT, AMZN, NVDA, GOOGL, BRK.B, GOOG, META, XOM, UNH and TSLA. Data are as of June 5, 2023.

To start, although futures markets are no longer pricing in an interest rate cut over the summer, expectations for policy easing in the back half of the year may be too dovish. With core inflation sticky and rhetoric from various Federal Reserve governors suggesting they would prefer to keep interest rates higher for longer, it seems reasonable to expect further adjustment in the pricing of policy over the coming months. The subsequent impact on rates has the potential to weigh on valuations of the large growth stocks that have accounted for the majority of the market's return this year.

The second issue at hand surrounds the outlook for economic growth. Will the economy fall into recession and will any such recession be short and shallow? Or will stress in the banking system amplify any downturn? What about a series of rolling recessions across different sectors and industries? The reality is that slower growth will lead to flat or declining earnings expectations, which, coupled with the valuation scenario above, could create a challenging environment for equity markets later this year. However, establishing a new market low seems like a bit of a stretch, which leaves us inclined to add to equities on weakness.

Given this backdrop we remain defensive, with shorter-duration equities still attractive given the optionality they provide. This leaves us focused on consumer staples, utilities and health care, but willing to add to profitable growth stocks on the back of any valuation re-rating. Importantly, markets are discounting mechanisms, and will begin pricing in a better tomorrow while there are still clouds on the horizon. This suggests that investors will need to be nimble with their equity allocations during the second half of the year.

International equities: Upside to international earnings estimates versus downside in U.S.

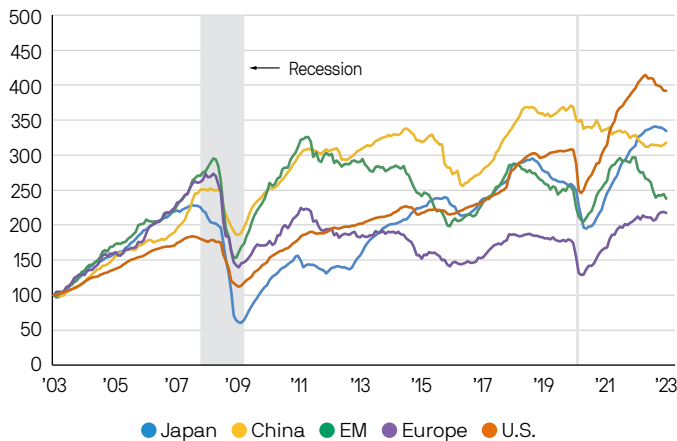
After underperforming the U.S. for 14 years by 277 percentage points, international equities have been outperforming for 1.5 years by 3 percentage points. Since October 2022, China, the eurozone, Japan and emerging markets (EM) have outperformed by 18 percentage points, 15 percentage points, 11 percentage points and 6 percentage points respectively (in U.S. dollars). As we argued late last year, expectations for the global economy had become too gloomy, suggesting this strong rebound. Going forward, is this international leadership sustainable?

Absolute and relative valuations are still favorable, the U.S. dollar is still too strong and positive surprises on international economic growth suggest upgrades to earnings expectations (versus downgrades in the U.S.). This divergence in earnings expectations is key for returns going forward, as this year's 8% return for the MSCI All Country World Index ex-U.S. has been driven by multiple expansion and the currency. While multiples and currencies still have room to contribute in some regions (Europe, Japan, Canada) given discounted valuations, the next catalyst for international performance is likely to come from upgrades to earnings expectations, especially for emerging markets. While China's 2023 economic estimates have been revised up significantly (4.8% in December to 5.5% today), Chinese earnings estimates have moved up only 1.0 percentage points and EM earnings estimates have *fallen* 1.9 percentage points year-to-date. More confidence in China's recovery, combined with a strong 1Q earnings season and upgraded corporate guidance, should provide a catalyst for an upswing in earnings estimates. This should allow EM to go from a laggard to a leader.

However, the key argument for a new cycle of international outperformance is a change in sector leadership. International markets have a much greater tilt toward value sectors (industrials, financials, energy and materials) versus the U.S.: 47% versus 27% of market capitalization. The long-term change in the macroeconomic picture (and hence the earnings picture) provides a catalyst for those sectors to lead: from low to normal inflation, from negative to positive interest rates and from fiscal austerity to public/private capex spend. These changes are powerful tailwinds instead of headwinds for developed markets ex-U.S. We have seen this change in leadership before: following the bursting of the “dot com bubble” and before interest rates were slashed post-“financial crisis” (2000-2007), value outperformed growth by 54 percentage points and international outperformed the U.S. by 83 percentage points.

Global earnings expectations are likely to diverge, with upside overseas and downside in the U.S.

Exhibit 8: Mar. 2003 = 100, next 12 months consensus estimates, U.S. dollars



Source: FactSet, MSCI, Standard & Poor’s, J.P. Morgan Asset Management. Next 12 months consensus estimates are based on pro-forma earnings and are in U.S. dollars. MSCI Europe includes the eurozone as well as countries not in the currency bloc, such as Norway, Sweden, Switzerland and the UK (which collectively make up 44% of the overall index). Past performance is not a reliable indicator of current and future results. Guide to the Markets – U.S. Data are as of June 5, 2023.

It is key for investors to be positioned for the cycle ahead, not the cycle behind us. International equity allocation reached a low of only 18% of a portfolio’s equity in November – but sentiment is changing quickly. As of April, this allocation is already up to 23%. With that said, this still represents a 12 percentage point underweight to international versus “neutral” – an important call to action for investors to not be caught offside with the next decade’s leadership.

Alternatives: The place to hide when rates are high?

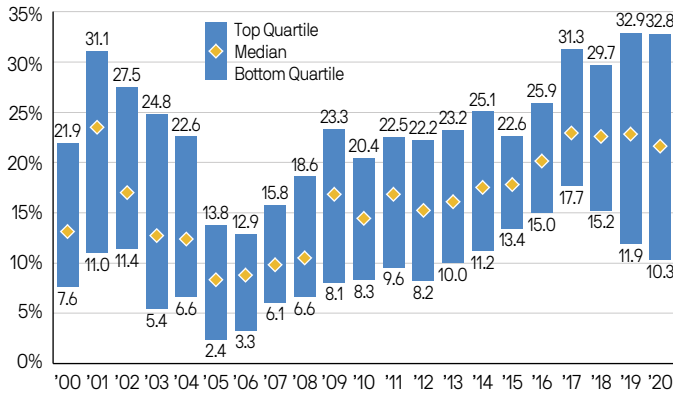
The onset of higher interest rates and reset in equity valuations last year have left some questioning the wisdom of owning alternative assets. While we recognize that there is a near-term opportunity in traditional assets, this opportunity will likely be fleeting – regardless of one’s precise view on Fed policy and the contours of growth going forward, lower rates and a more challenging environment for equity returns seem to be on the horizon.

As such, we still see room for alternatives to enhance returns, generate income and provide diversification. Private equity buyout valuations have been far more resilient than their venture counterparts, mostly because these businesses were able to generate decent earnings growth in 2022. While there may be further downside ahead, it is important to remember that some of the best private equity vintages were ones that coincided with economic slowdowns and recessions. Furthermore, as growth slows this year we do expect default rates to rise, creating an opportunity for distressed and special situations investors.

We also continue to see value in core real assets, even in an environment where capital values decline. Real estate markets are characterized by significant dispersion, as the industrial sector has the wind at its back, while office continues to struggle. Meanwhile, infrastructure assets can provide similar income streams and inflation protection, serving as a hedge against an inflation revival. Finally, direct lending may soften as growth slows and financial conditions tighten, but the flexibility and higher quality nature of these loans leave the asset class looking favorable from a structural perspective.

Private equity funds continue to exhibit wide divergence

Exhibit 9: Global private equity return dispersion by vintage year, 2000-2020, Internal rate of return (IRR)



Source: Burgiss, J.P. Morgan Asset Management. Global private equity is represented by global buyout funds. IRR performance data is as of December 31, 2022. Data are as of June 5, 2023.

Finally, hedge funds can provide diversification benefits over and above traditional fixed income. 2022 saw stock/bond correlations turn positive, leaving many investors with nowhere to hide. However, hedge funds demonstrated an ability to zig when other markets zagged; this dynamic, in conjunction with higher base rates and volatility, should support performance during the back half of the year.

As always, however, we believe that allocating to alternatives is a multi-step process. First, an investor needs to identify the problem they are looking to solve, and subsequently back into the appropriate type of alternative investment. From there, manager selection takes on an outsized role, as dispersion in private market returns tends to be far wider than is observed in public markets.

ESG: Policy progress positions private sector participation

The last 18 months have seen a significant slowdown in flows into ESG funds, as the sober reality of higher rates has kept risk assets in check. Yet, over the same period, policymakers have continued to make meaningful commitments to the energy transition that should support private sector investments, providing opportunities for long-term investors.

In the U.S., the Inflation Reduction Act of 2022, which provides USD 369 billion in green subsidies, is projected to drive nearly USD 3.5 trillion¹ in cumulative capital investment into energy infrastructure over the next decade. This year, Europe responded with its own package of subsidies and regulatory reform with the Green Deal Industrial Plan. The UK followed, opting to lead with regulatory reform rather than new funding commitments, a tack that could gain greater traction in the future as global government spending becomes constrained by higher debt and deficits.

Now that policymakers have cleared the initial hurdle of making sizable commitments, the private sector can leverage these incentives to bring various technologies and infrastructure to scale. Key beneficiaries are likely to be solar and wind installations, electric vehicles, batteries, grid infrastructure, energy efficient appliances, heating and cooling systems and nascent technologies like hydrogen and carbon capture. While this presents many compelling opportunities, investors ought to focus on companies with either established products or more diversified business segments, a clear pathway to profitability and sensible valuations. The energy transition offers many growth opportunities, but there will be winners and losers, particularly as rates remain higher and economic growth slows, so investors should maintain an eye toward quality.

¹ Princeton University Zero Lab.

Asset allocation and cyclical location: Positioning for turning tides

As investors look into the back half of this year, it is clear that the backdrop for investing has changed from the beginning of 2023. It is unclear, however, whether this change has been for the better or the worse – as some old sources of uncertainty have faded, new ones have cropped up to take their place.

The position within the U.S. economic cycle remains top of mind with investors still pondering the much-discussed and predicted recession. The U.S. economy's remarkable resilience has confounded the skeptics and even now a recession does not feel inevitable. Still, challenges exist.

Higher interest rates have had an impact across the economy, with higher mortgage rates exerting significant downward pressure on homebuilding activity and higher borrowing rates dampening both business and consumer spending. A divided government in the U.S. following mid-term elections last year suggests that future fiscal stimulus will be limited. Meanwhile, the re-acceleration in global economic momentum, which got off to a bumpy start last year, now feels a bit more stable, and narrowing interest rate differentials mean that the U.S. dollar may no longer be a headwind for international investors.

In other words, investing is still quite complicated.

The natural next question, then, is: How should investors be positioned?

After more than a year of aggressive U.S. monetary policy tightening, the market is now talking about a pause or a pivot rather than more hikes. For this reason, fixed income investors may consider making a larger allocation to duration while shoring up quality to account for tighter-than-expected spreads.

From an equity perspective, investors should look primarily toward profitability, especially since valuations have ballooned on the hope for interest rate cuts that may not fully materialize. This favors an allocation primarily to quality regardless of sector tilt. Outside the U.S., cyclically oriented markets like Europe and Japan could benefit from the global recovery. Moreover, a falling dollar alongside a re-opened China should present attractive opportunities in both developed and emerging markets for U.S.-based investors.

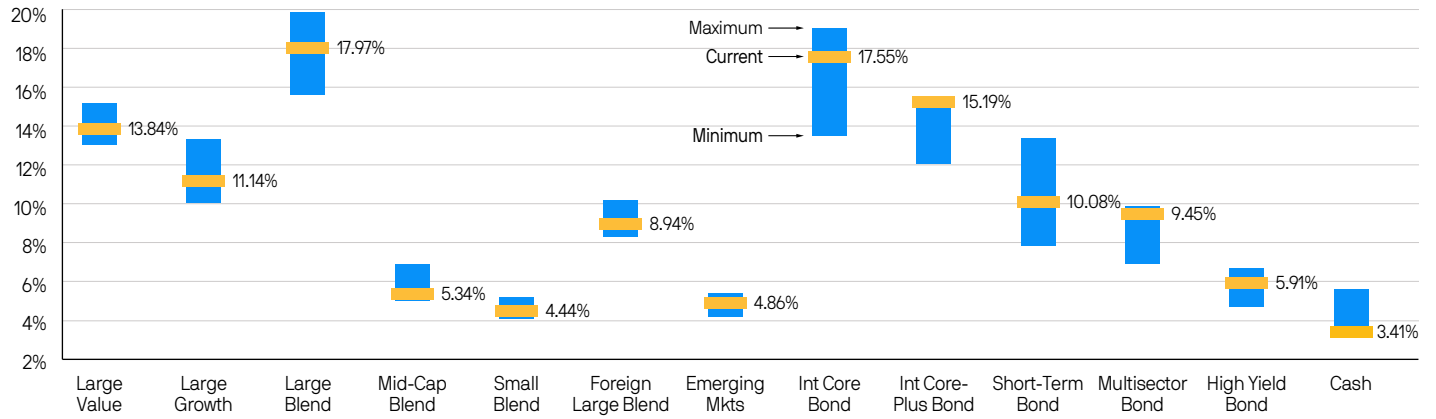
This changing backdrop should also push investors to further diversify portfolios. Cross-asset correlations are well positioned to “normalize” this year, suggesting that both stocks and bonds can play their traditional roles in portfolio construction. In addition, investors should consider a heartier allocation to alternatives, which are typically uncorrelated to public markets and in some cases have healthy income streams. Meanwhile, while rising interest rates proved a significant headwind for ESG investing in 2022, the turning tide on central bank policy coupled with the long-term reality of decarbonization suggest that this investing style is not dead.

Looking at portfolio positioning, this outlook has largely been implemented, as can be seen in **Exhibit 10**. Fixed income allocations to intermediate duration core and core-plus bonds are elevated as portfolios start to position for the end of the rate hiking cycle; moreover, appetites for dedicated high yield have continued to move lower as investors embrace flexibility. In equities, allocations to both sides of the style box are being trimmed as investors focus more down the middle in blended portfolios of both growth and value stocks. Meanwhile, allocations to international equities across both developed and emerging markets are among the highest seen in over a year.

All told, the investing landscape is challenged, and predicting the winners and losers in periods of heightened uncertainty is nearly impossible. Instead, the best way to approach asset allocation is to both broadly diversify and to work with active managers.

Investors are generally well-positioned to take advantage of market opportunities

Exhibit 10: Average allocations in moderate models, last 12 months



Source: J.P. Morgan Asset Management. For illustrative purposes only. Past performance is not indicative of future results. Data are as of June 5, 2023.

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Index Definitions

All indexes are unmanaged and an individual cannot invest directly in an index. Index returns do not include fees or expenses.

The **Composite PMI future output index** is a gauge of economic growth and can provide valuable insights into GDP, service sector growth and industrial production trends well ahead of official data.

The **Bloomberg Euro Aggregate Corporate Index** is a benchmark that measures the corporate component of the Euro Aggregate Index. It includes investment grade, euro-denominated, fixed-rate securities.

The **Bloomberg Pan-European High Yield Index** measures the market of non-investment grade, fixed-rate corporate bonds denominated in the following currencies: euro, pounds sterling, Danish krone, Norwegian krone, Swedish krona, and Swiss franc. Inclusion is based on the currency of issue, and not the domicile of the issuer. The index excludes emerging market debt.

The **Bloomberg U.S. Aggregate Treasury Bond Index** is a broad-based benchmark that measures the investment grade, U.S. dollar denominated, fixed-rate taxable bond market. This includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities and collateralized mortgage-backed securities.

The **ICE BofA MOVE Index** tracks fixed income market volatility.

The **J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)** is an expansion of the J.P. Morgan Corporate Emerging Markets Bond Index (CEMBI). The CEMBI is a market capitalization weighted index consisting of U.S. dollar denominated emerging market corporate bonds.

The **J.P. Morgan Emerging Markets Bond Index Global Diversified (EMBI Global Diversified)** tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds. The index limits the exposure of some of the larger countries.

The **J.P. Morgan GBI EM Global Diversified** tracks the performance of local currency debt issued by emerging market governments, whose debt is accessible by most of the international investor base.

The **J.P. Morgan Leveraged Loan Index** is designed to mirror the investable universe of U.S. leveraged loans.

The **MSCI ACWI (All Country World Index)** is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets.

The **MSCI EAFE Index (Europe, Australasia, Far East)** is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

The **MSCI Emerging Markets Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

The **MSCI Europe Index** is a free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe.

The **MSCI Pacific Index** is a free float-adjusted market capitalization index that is designed to measure equity market performance in the Pacific region.

The **MSCI World with USA Gross Index** measures the performance of the large and mid-cap segments across 23 Developed Markets (DM) countries. With 1,540 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The **Russell 1000 Index**[®] measures the performance of the 1,000 largest companies in the Russell 3000.

The **Russell 1000 Value Index**[®] measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The **S&P 500 Index** is widely regarded as the best single gauge of the U.S. equities market. The index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The **S&P 500 Index** focuses on the large-cap segment of the market; however, since it includes a significant portion of the total value of the market, it also represents the market.

The **U.S. Treasury Index** is a component of the U.S. Government index.

J.P. Morgan Asset Management

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