NEUBERGER BERMAN

Asset Allocation Committee Outlook 3Q22

Into the Inflationary Slowdown

Whether or not the economy falls into a recession, as technically defined, we believe equity investors are going to feel like they're in one as the valuation adjustment of the first half of 2022 is followed by downward revisions to earnings forecasts in the second half. Credit markets are closer to pricing for a recession as spreads have widened, while government bond yields have risen with tighter central bank policy. That means the Asset Allocation Committee now sees more yield potential in fixed income but remains cautious in equities; it continues to favor commodities, uncorrelated strategies and cash to help mitigate potential volatility and seek opportunistic investments.

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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 29 years of experience.

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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 3Q 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

	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)	○	○	● ←	○	○

> "Recession or not, the next 12—18 months is going to feel like one, especially for equity investors."
>
> **Raheel Siddiqui |** Senior Research Analyst—Global Equity Research

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"This is likely to be a difficult period. But difficult periods tend to be a time of opportunity, when the foundations of potential long-term returns are built."

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

Into the Inflationary Slowdown

Last quarter, the Asset Allocation Committee ("the AAC" or "the Committee") adopted an underweight view on global equities and leaned more heavily into cash, commodities and other alternative, diversifying assets. This reflected our anticipation of stickier inflation, tightening financial conditions and heightened volatility—and indeed the second quarter was characterized by hawkish central banks, rapidly rising rates and tumbling equity markets. We expect these volatile conditions to persist as the increasingly difficult inflation outlook raises the probability of recession. Whether or not the U.S. economy falls into a recession, as technically defined, we believe equity investors are going to feel like they're in one, as the valuation adjustment of the first half of 2022 is followed by downward revisions to earnings forecasts in the second half. Credit markets are closer to pricing for a recession as spreads have widened, while government bond yields have risen with tighter central bank policy. That means the AAC now sees more yield potential in fixed income, favors commodities for ongoing inflation exposure, but remains cautious in equities. We anticipate high uncertainty and volatility for at least the next 9 – 12 months. In that environment, uncorrelated and short-term trading strategies remain useful, as does cash—as both a buffer against potential market volatility and as dry powder for seeking opportunistic investments. The coming months are likely to be difficult, but difficult periods are those in which the foundations of potential long-term returns are built.

Are We Heading for Recession?

To formulate asset allocation views for the next 12 months, it's critical to have a view on where the economy is going. To have a view on the economy, it's necessary to have an opinion about the path of central bank interest rates. To have a view on rates, right now, means having a view on inflation and inflation expectations. And to form a view on inflation in today's environment, the major factor to grapple with is the price of oil.

The outlook on oil remains challenging. While some blockages to supply could conceivably be loosened over the coming months, there is little sign of relief from the main challenges, which are the conflict in Ukraine and the impact of a decade of chronic under-investment.

The fact that oil traded above $100/bbl while large parts of China have been under full COVID-19 lockdowns suggests just how imbalanced supply and demand is. Demand from China may be coming back just as the northern hemisphere enters its season for vacation travel and winter reserves-building. OPEC exhibits little capacity for additional supply, and efforts to release reserves and protect consumers with subsidies have so far only supported demand and pushed the price of oil and refined products higher.

We therefore think that the price of oil and many other commodities have further to climb, and that the impact of that on inflation and interest rates will be complex.

High prices ultimately tend to be the cure for high prices: there comes a point when it is more economical to close a factory than pay for power. So, our first question is, how high might that price be? On the eve of the Great Recession of 2007 – 9, it was around $140/bbl. The equivalent of that today might be $185/bbl or more—but perhaps lower elsewhere, where weaker currencies add to the cost.

Our second question is, how much weight are central banks likely to place on that price? By delivering 150 basis points in interest rate hikes over three months, the U.S. Federal Reserve (Fed) has managed to get long-dated real rates meaningfully positive. We expect a continued aggressive stance over the near term, with the Fed Funds Rate likely to shift up to around 3.25% – 3.75% as core inflation pulls back below 5%. We are beginning to see tentative signs that wages and goods inflation is easing, but the Fed itself has complicated the picture by expressing concern about headline inflation items such as consumer gasoline prices. If it does indeed intend to consider its policy rate relative to headline inflation, our view on the oil price implies significantly tighter monetary policy than what is currently priced in.

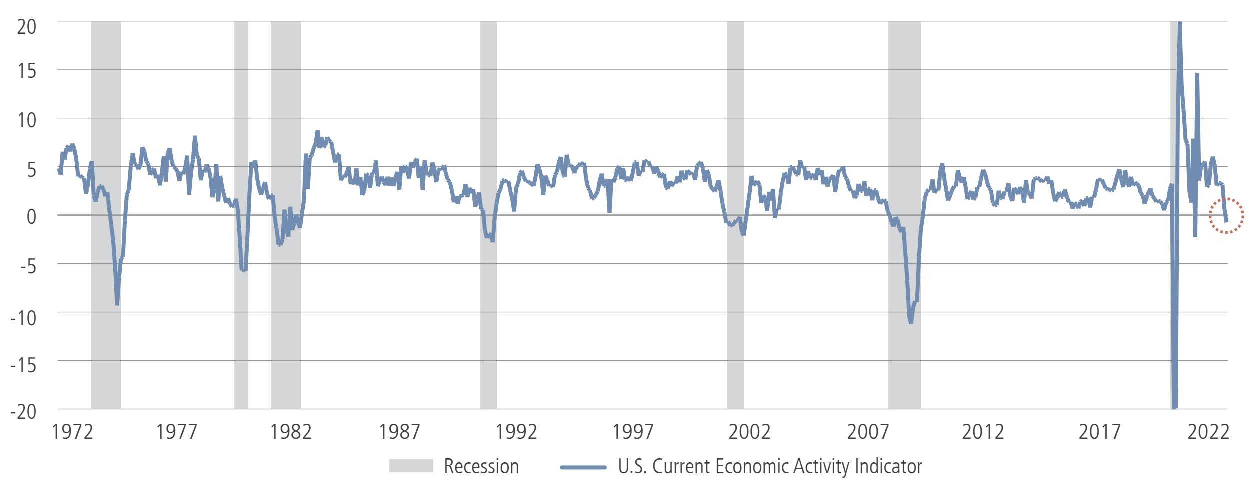
We think that seeing core inflation fall below 5% will persuade the Fed that it is on the right track. We also think it is likely to acknowledge that there is little it can do to ease energy supply constraints and allow high prices to crimp demand naturally. An uptick in unemployment as conditions tighten in the second half of this year could give policymakers another reason to pause and take stock.

Could that translate into a technical recession in the U.S.?

Goldman Sachs' Current Economic Activity Index, which has rarely turned negative outside of a recession, recently dipped below zero—but it has been exceptionally volatile since the COVID-19 shock. A recent paper from the New York Fed suggests that recession is a 50/50 call over the next 12 months, and while some members of the Committee are more prepared to call for a U.S. recession, and some even for a recession this year, on balance we are inclined to agree with that 50/50 view.

THIS INDICATOR, RARELY NEGATIVE OUTSIDE OF A RECESSION, JUST DIPPED BELOW ZERO

Goldman Sachs U.S. Current Activity Index



Source: Bloomberg, Goldman Sachs. Data as of June 27, 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.

What every AAC member does agree on is that the probability has been rising, and continues to rise with every month of higher inflation—and that the recession-or-not debate may distract investors from two more important points.

First, we anticipate that the coming slowdown will be due to consumers tightening their belts rather than systemic problems in the financial, industrial or housing sectors. Bank and corporate balance sheets are in good shape to absorb tighter conditions, and it's unlikely to be falling house prices and mortgage foreclosures that erode consumer wealth, but losses in equity, bond and cryptocurrency portfolios. For these reasons, we think even a full recession is likely to be relatively shallow.

That leads us to the second point. Technical recession or not, we think the coming slowdown and market volatility could feel like one for investors—and particularly equity investors.

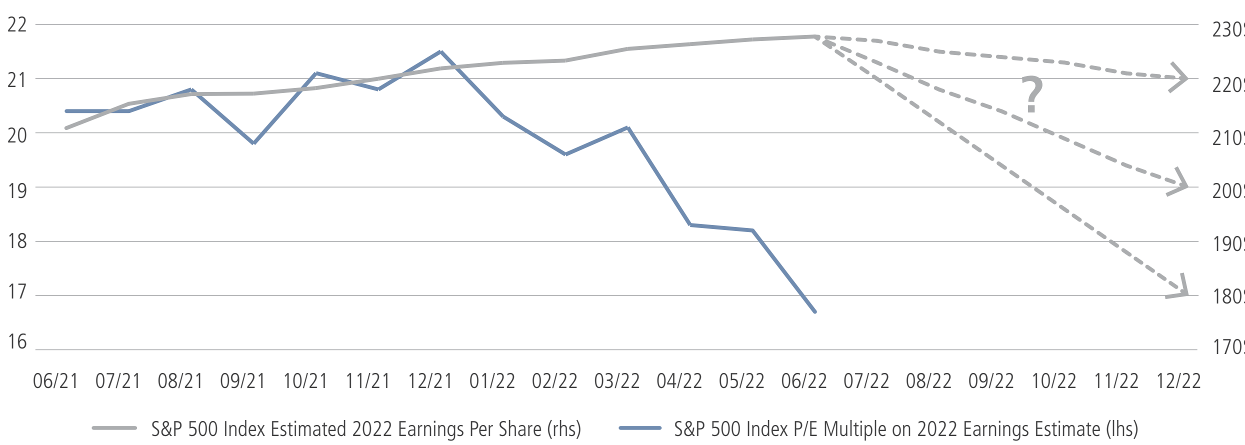
Equities: Valuations Have Adjusted, But Earnings Forecasts Have Not

The AAC adopted a more risk-averse set of views in its outlook last quarter, and the picture outlined above takes us further in that direction.

Our view on the entire equities complex is now underweight. Last quarter, we were neutral on U.S. broad capitalization exposure, which includes small and mid-sized companies, because small and mid-cap stocks have tended to be less sensitive to interest rates than growth-oriented U.S. large caps. These longer-duration growth companies were indeed punished by the rapid rise in real yields since March. Downgrading smaller companies reflects a shift in our focus from interest-rate exposure to earnings, which is an important evolution in our overall outlook for equities.

The equity market sell-off in the first half of 2022 can be explained almost entirely by a single factor: the change in the discount rate. The invasion of Ukraine had very little lasting impact, and top-down economic growth estimates and bottom-up earnings forecasts have had no apparent impact at all. Consensus forecasts for 2022 S&P 500 Index earnings are still at around $230 per share, which would be 10% growth on last year. For 2023, the forecast is $250 per share. These estimates have barely moved since the start of the year, indeed they have been slightly upgraded: the sell-off has apparently been all about an adjusted valuation of the same set of forecast earnings.

VALUATION MULTIPLES HAVE ADJUSTED, BUT NOT EARNINGS ESTIMATES



Source: FactSet. Data as of June 24, 2022. Earnings estimate are FactSet's calculation of consensus earnings per share for the S&P 500 Index over the calendar year 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.**

Those forecasts look increasingly doubtful against the top-down picture we have painted. Revenues arrive as nominal dollars, and could therefore face a steep decline just through the anticipated decline in inflation later this year. With slowing inflation and slowing economic activity, 2022 could easily see a seven-percentage-point decline in nominal GDP. History suggests that could translate into a 15- to 20-percentage-point hit to earnings, and additional downward pressure on equities.

There are caveats to state here. Valuation multiples could fall still further. On the other hand, companies can take action to defend their margins. Ultimately, we find it difficult to see how equity markets can escape a second, earnings-related sell-off after the valuation-related sell-off of the past six months. Given this cautious outlook, within its general underweight view on equities, the AAC therefore favors lower-beta exposures, with the exception of a more favorable view on energy (for inflation exposure) and a less favorable view on the consumer durables sector (in light of the anticipated consumer-led slowdown).

Fixed Income: More Yield and Credit Spread to Work With

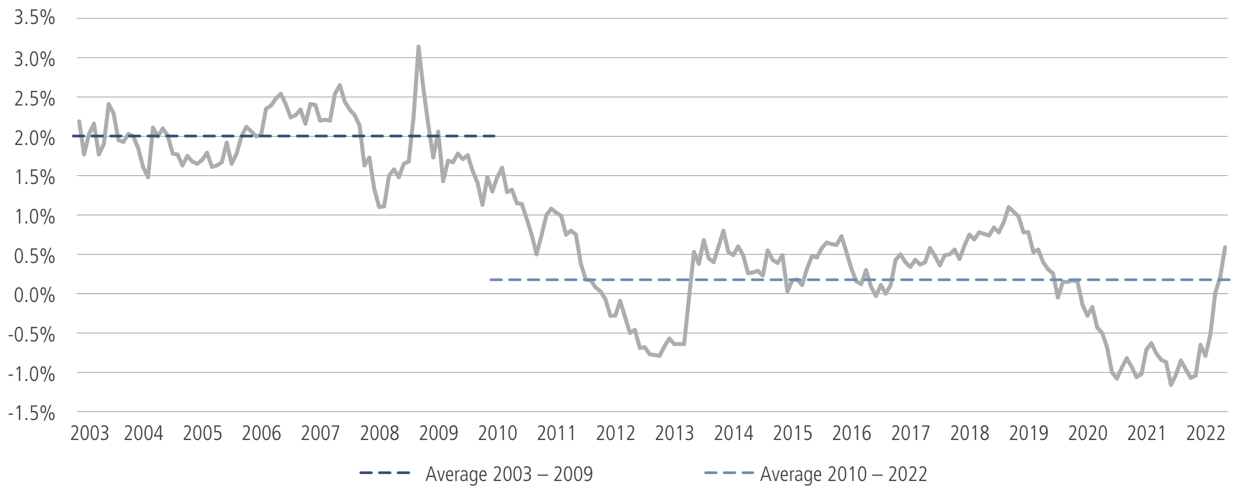
The Committee regards longer-dated Treasury yields as increasingly priced for the long-run neutral Fed policy rate of around 2.25% – 2.50%. As the central bank works its way toward 3.25% – 3.75% this year, we therefore expect the 10-year yield to stay capped in the range of 300 – 350 basis points.

For the first time in a long while, therefore, we believe investment grade government and corporate bonds offer opportunities for relatively attractive levels of income, as well as the potential for moderate capital appreciation—and defensive diversification—in the event of an economic slowdown. The Committee has upgraded its view on investment grade from underweight to overweight.

Again, there are caveats. Should a 3.75% policy rate and current real yields prove insufficient to tame core inflation, or should the Fed remain concerned about energy prices, conditions may need to tighten further, with a tail risk of the 10-year yield hitting 400 basis points. It's worth noting that, while yields have risen rapidly this year, they remain low relative to long-run averages.

RATES HAVE RISEN RAPIDLY, BUT HAVE THEY RISEN ENOUGH?

U.S. 10-year real yields, 2003 – 2022



Source: Federal Reserve Bank of St Louis (FRED). Data as of June 26, 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.

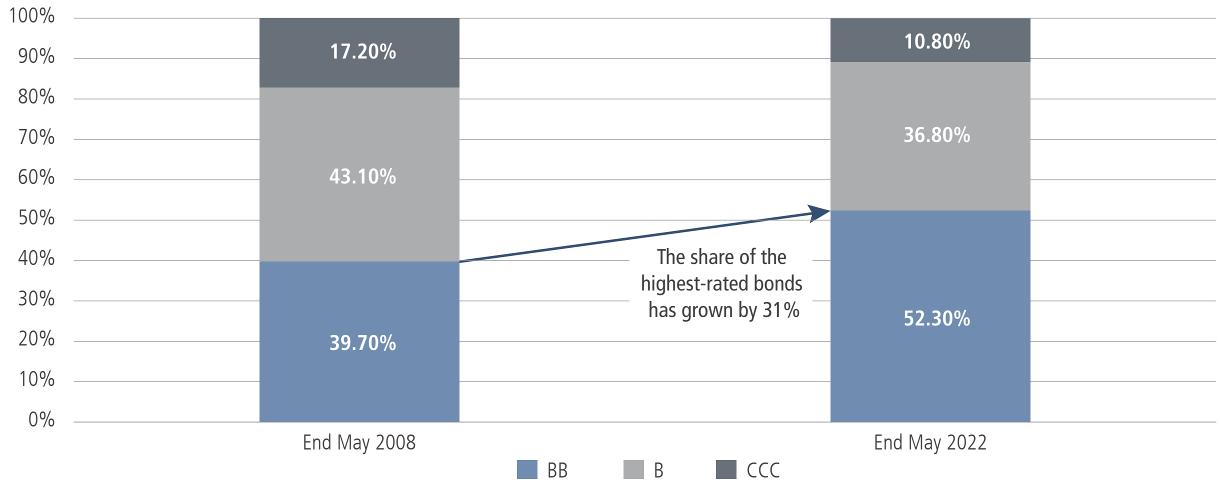
The one call we clearly got wrong last quarter was to leave our view on high yield bonds overweight. This quarter, the AAC has downgraded its view to neutral, acknowledging that recession risk threatens more potential price volatility in the near term; should that volatility stabilize, the Committee may look to upgrade its view again.

Our fixed income team has stress-tested for a full recession, which is a worse outlook than our current base case, and even in that scenario the outlook for defaults remains relatively benign.

The energy sector, which has been a significant source of credit stress over recent years, is benefitting from the run-up in commodity prices. Over the past decade, riskier private equity deals have tended to be financed with leveraged loans rather than in the high yield bond market. The average credit quality of the high yield universe has improved markedly since the Great Financial Crisis. We also think the impact on the high yield market of a relatively shallow, consumer-led slowdown would be relatively mild.

HIGH YIELD HAS BECOME A HIGHER-QUALITY ASSET CLASS

Share of ICE BoA U.S. High Yield Index by credit rating, 2008 and 2022



Source: Bank of America. Data as of May 31, 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. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Despite all of that, and unlike the equity market, credit has re-priced well in excess of the rise in rates. High yield spreads at around 500 basis points, offering 8% yield, look to us like near-recessionary levels and could present a relatively attractive way to take risk once the current volatility stabilizes. Even then, however, recession risk will heighten the need for selectivity and a focus on quality.

Alternatives and Opportunistic Investments: Time to be Nimble

The Committee's views on real and alternative assets are unchanged this quarter.

While commodity prices have risen substantially this year, we regard the supply and demand issues besetting many commodity sectors as structural, not easily resolved, and supportive of prices over a long cycle to come. This not only increases the potential for price appreciation, in our view, but also increases the "roll yield" by pushing near-dated futures prices higher than those for longer-dated contracts.

The Committee retains its overweight view on private markets. We particularly favor real estate for its inflation sensitivity, which comes from the supply constraints associated with costlier building materials and wages, and the natural and contractual exposure baked into many leases. For more on our thinking around private markets, see "Up for Debate: Can Private Markets Perform Well When Public Markets Are Under Pressure?"

We continue to favor hedge funds and other liquid alternative strategies, which have the potential to deliver uncorrelated return streams, while the outlook remains challenging for equities. We particularly 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.

For the same reasons, the AAC retains an overweight view on cash, as both a buffer against potential market volatility and as dry powder for seeking opportunistic investments. Each quarter, members of the Committee are asked to submit suggestions for these opportunistic allocations, and it is notable that this quarter's list was longer than ever, covering a range of ideas from gold and wheat to China's re-opening, emerging Asia and mortgage-backed securities.

That is perhaps a good indicator of the Committee's broad outlook as we head into the second half of 2022. Overall, there is no mistaking the generally risk-averse tenor of our views for the next 12 – 18 months, when we expect a substantial economic slowdown, ongoing volatility in markets and a high level of uncertainty. This is likely to be a difficult period. But difficult periods tend to be a time of opportunity, when the foundations of potential long-term returns are built.

UP FOR DEBATE:

WILL U.S. OR NON-U.S. EQUITIES PROVIDE MORE SHELTER FROM A SLOWDOWN?

U.S. and European large cap equity indices have fared similarly since the beginning of this year. Surprisingly, Europe has actually outperformed the U.S. somewhat since the outbreak of war in Ukraine, which coincided with the start of the rapid run-up in U.S. real yields. Nonetheless, valuations still favor Europe: the forward price-to-earnings ratio of the S&P 500 Index is around 16 times, whereas for the Stoxx Europe 600 Index it is just 12 times.

A minority of members on the Asset Allocation Committee ("AAC" or "Committee") see this as a reason to question the assumption that the U.S. market is the more defensive.

The fundamental picture also offers partial support for that view. European economic activity has held up better than was feared when war broke out in February, probably due to fiscal policy being almost as accommodative as it is in the U.S., and monetary policy being even more accommodative. This policy stance was in turn enabled by less severe wage pressures: Europe's labor market was much less tight than that of the U.S. coming into the COVID-19 pandemic, and the widespread decision to subsidize workers to stay in their jobs meant that it remained less tight during re-opening and recovery last year.

That outlook may have reversed with the invasion of Ukraine, however, which turned the inflation story into one primarily about energy and food prices rather than labor markets and wages. Europe now appears to be much closer to the global inflation epicenter. Furthermore, these dynamics are heightening the risk of a return to dislocations between core and peripheral eurozone government bond markets.

There are other reasons to believe that U.S. stocks can reassert their lower-risk status in the second half of this year.

As we describe in this quarter's *Outlook*, the equity sell-off this year has so far been almost entirely about rising interest rates and valuation adjustment. U.S. large-cap indices, which have become dominated by growth stocks over recent years, were particularly exposed to this adjustment. We now believe that most of that "froth" has dissolved: while U.S. large cap indices are not cheap, the dispersion between the median and the most expensive stocks is now in the middle of its historical range, and we believe that we are close to if not past the peak in U.S. Treasury yields. That makes us think that valuation will no longer be the primary driver of regional relative performance.

As such, we favor U.S. equities as the lower-beta exposure going into the anticipated slowdown. Outside the U.S., we are more inclined to favor Japan over Europe, where the weak yen is supporting exports and inflationary pressures are much less severe.

VALUATIONS FAVOR EUROPEAN EQUITIES, BUT THE U.S. IS NO LONGER "FROTHY"

Source: FactSet. Data as of June 26, 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. 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:

CAN PRIVATE MARKETS PERFORM WELL WHEN PUBLIC MARKETS ARE UNDER PRESSURE?

The Asset Allocation Committee ("AAC" or "Committee") retained its overweight view on private markets this quarter.

That outlook that was questioned by some members, who pointed to the general risk-off tenor of the Committee's views, the exposure of these leveraged investments to higher interest rates, the growing difficulty of achieving exits in volatile public markets, and the long-duration profile of many private companies' projected earnings streams—which seems likely to hit valuations over the coming months in much the same way as it hit public market valuations in the first half of 2022.

Against this, a number of factors support the Committee's overweight consensus: investor flows, relative valuations, flexibility, diversity, and the nature of the private investing cycle.

There is an ongoing structural flow of institutional funds into private markets, which we believe is likely to persist through the anticipated downturn and support competition for quality assets. One reason for this flow is to harvest the liquidity premium from private markets and take advantage of valuations that have become competitive against public markets over recent years. We see some deals failing or being renegotiated as buyers become more wary about pricing, which suggests that valuations are set to adjust downwards; nonetheless, multiples still favor the average private over the average public company.

In addition, private companies often have more flexibility to adapt operationally to the changing economic environment: sustaining margins through a slowdown may be easier for a smaller company working out of the glare of the public market. This flexibility extends to capital structure, which is why, historically, relatively high leverage has not been the challenge one might expect in rising rate environments: most debt is covenant-lite or even covenant-free, and it is much easier for private investors to inject equity than it is for either family owners or public owners of businesses. And it's not just private equity businesses that have flexibility; private equity funds do, too. Without the pressures of investor redemptions, private equity fund managers are more likely to have dry powder to invest opportunistically as company valuations decline—including investments in public-to-private buyouts.

Private markets are also very diverse. Technology LBOs transacted in the past two or three years may present downside risk, but the picture can look very different in venture, growth, industrial sectors and emerging markets; in private debt, real estate, infrastructure and niche assets such as trademarks and royalties; and in strategies such as distressed investing, special situations and capital solutions.

Most importantly, the Committee acknowledges that investing in private markets tends to involve committing capital for multiple years. When we articulate our view, 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 nature of private investing means that commitments made today tend to be put to work as investments over the subsequent four to six years: historically, that has led to some of the best performing private equity vintages being raised after we have seen the top of public market valuations, because the commitments were invested as equity valuations declined.

We would therefore have a neutral-to-overweight view through most of the equity cycle; an underweight view on new commitments as exuberance is building in public markets; and an overweight view on new commitments when we anticipate a turn in the cycle and the start of a downturn. On that basis, those on the Committee favoring an overweight view commented that they were more optimistic about private equity now than at any time in the past three years.

With hindsight, should the Committee have adopted a neutral or underweight view perhaps three or four quarters ago? On the one hand, that is arguable: at the time, we still thought it likely that the post-pandemic cycle would be another long-lived, albeit more volatile one, with the peak still far into the future—it has since become clear that inflationary dynamics threaten to cut it short. On the other hand, these decisions are always about relative value as well as the cycle: even with hindsight, while private equity valuations may have hit a cyclical high over the past year, they have been consistently attractive relative to extraordinarily high public market valuations.

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 neutral to underweight.
- While U.S. equities have endured a substantial sell-off in the first half of 2022, this has been almost entirely due to a valuation adjustment: earnings estimates have barely moved, and we believe they will be revised downward meaningfully in the second half of the year.
- Broad capitalization exposure, which includes smaller companies, was previously favored for its lower exposure to rising interest rates relative to the growth-dominated large cap segment; but smaller caps are unlikely to be a shelter from an economic slowdown and lower earnings estimates.
- The AAC continues to favor lower beta equity exposure for defensiveness and reduced exposure to rising rates; value over growth, with a defensive tilt via high-quality, income-oriented stocks; and energy and financials over consumer and industrial sectors, due to its anticipation of an inflationary economic slowdown.

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 its greater resilience against inflationary pressures, the invasion of Ukraine has introduced considerable uncertainty into the growth and inflation outlook for Europe.
- The AAC expects U.S. equities to reassert their lower-beta characteristics now that some of the frothier valuations of growth stocks have been corrected with the rise in interest rates.

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 upgraded its view from underweight to overweight.
- A rapid run-up in government bond yields, particularly in the U.S., as well as widening of credit spreads, has created meaningful value opportunity in investment grade for the first time in a long while.
- The AAC believes that current yields are close to their cycle peaks, and as such it favors a bigger role for investment grade in portfolios, generating income and potentially providing some capital appreciation and diversification in the event of an 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 there remains some way to go before they present attractive valuations.
- We see more attractive value opportunity in high yield and, following the recent run-up in rates, in U.S. investment grade markets.

High Yield Corporates ▼

- The Committee downgraded its view from overweight to neutral.
- Our fixed income team has stress-tested the high yield universe for a full recession, which suggests a worse outlook than our current base case, and even in that scenario the outlook for defaults remains relatively benign; but recession risk heightens the need for selectivity and a focus on quality amid potential near-term price volatility.
- The AAC believes that the general strength of corporate balance sheets will be supportive of credit markets as economic growth slows, while sounding a note of caution around issuers in the consumer discretionary sector, which could bear the brunt of the anticipated economic slowdown.

Emerging Markets Debt ◀▶

- The Committee maintained its neutral view.
- There may now be value opportunities in commodity-exporting countries, and in Asia as China emerges from its recent COVID-19 lockdowns, but these need to be balanced against political tail risk, and risks around global growth and the strength of the U.S. dollar.

REAL AND ALTERNATIVE ASSETS

Commodities ◀▶

- The Committee maintained its strong overweight view.
- Commodities were already one 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 maintained its overweight view.
- As we enter an anticipated 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, 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, 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.
- 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 maintained its overweight view.
- We believe that credit selection is important in a market that is increasingly borrower-friendly, and valuations now have some competition from public-market high yield credit; that said, floating rates may provide a buffer against tightening monetary policy and private companies could find it easier to defend their margins in the anticipated slowdown.
- 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 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, and benefits from a large current account surplus.
- The pivot to a more hawkish stance by the ECB is likely to draw capital flows back to Europe—and explicit discussion of a solution for peripheral eurozone spread dislocation could enable the central banks to achieve a higher terminal interest rate, and better address the inflation threat.
- Proximity to the Ukraine crisis means 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 now very short the currency, and hedged foreign investments are at their most attractive levels for years for JPY-based investors, although the Bank of Japan appears unwilling to adjust policy even in the face of rising inflation and the weakening in the currency.

GBP ◀▶

- The AAC maintained its underweight view.
- Despite being undervalued in PPP terms, stagflation concerns are elevated as the Bank of England is hiking rates into an economic slowdown, and a sales tax hike is adding to consumer costs when there is little sign of relief from rising inflation.

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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