Outlook

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CAPITAL GROUP℠

Long-term perspective on markets and economies

This material is a marketing communication

Rob Lovelace on all-weather investing

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The world has changed.

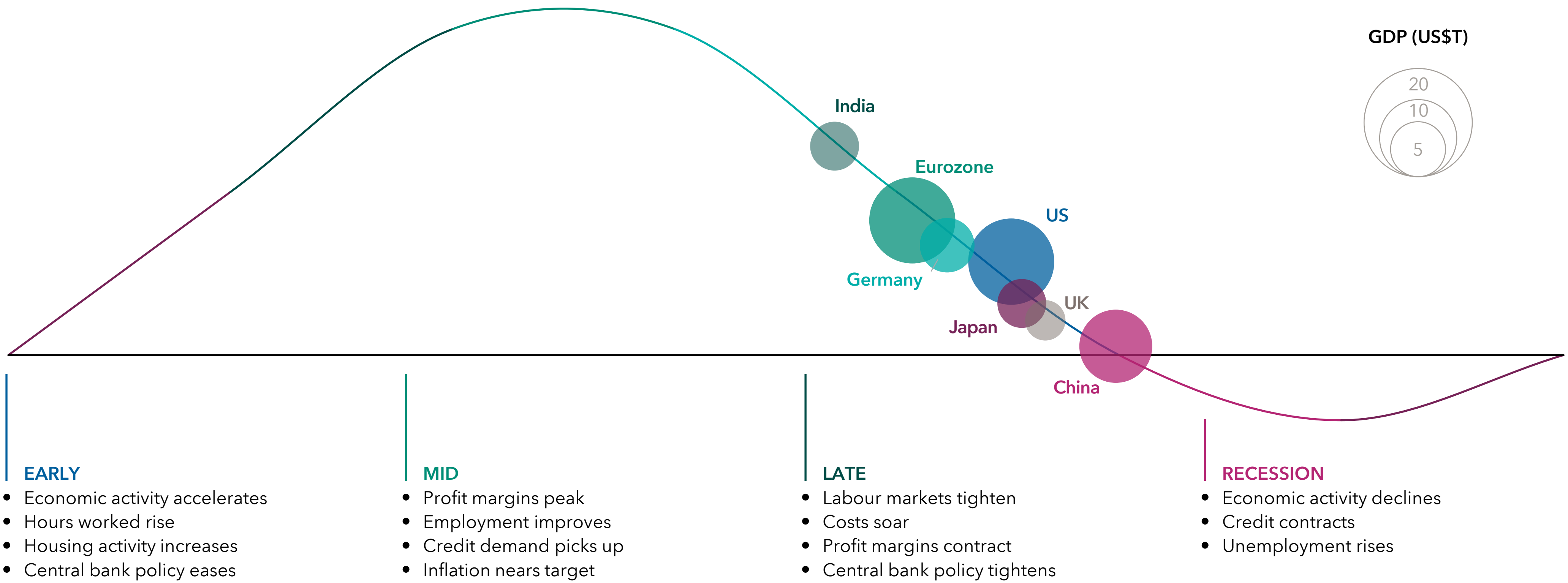
We are living through a pivotal time in history, marked by geopolitical realignment, high inflation, volatile financial markets and the end of a 40-year period of declining interest rates. The title of this new era could be *Brave New World* or *Back to the Future*. But the title I would select is *Revenge of the Boomers*, because a lot of these events are rhyming with the past, particularly the early 1960s. That's when we saw interest rates bottom out after decades of decline, as well as the rise of the Cold War era, which is unfortunately rearing its head again in some respects.

Despite these challenges, I remain optimistic about the investing environment for several reasons. First, there are still signs of growth as the global economy recovers from the pandemic. Second, I believe corporate earnings will be the driving force of equity markets going forward, as opposed to multiple expansion – a welcome return to fundamentals. And third, I think we will experience a healthy recession in the next year or two. For all the concerns about it, I see a moderate recession as necessary to clean out the excesses of the past decade. You can't have such a sustained period of growth without an occasional downturn to balance things out. It's normal. It's expected. It's healthy.

What does this mean for investors? Maintaining a balanced, "all-weather" portfolio makes sense in any environment, but particularly this one. Earlier this year, I reminded investors to keep an eye on valuations and prepare for a market correction. I remarked that I was buying a raincoat, but not putting it on yet. Turns out, it's nice to have that raincoat nearby. Market volatility has returned, but that's no reason to be discouraged. At Capital Group, we remain confident that we have the right people in place making decisions based on deep, company-specific fundamental research, which has always formed the basis of our long-term investment approach.

Indeed, the world has changed, but change creates opportunity.

Late cycle is a time for all-weather investing



Powerful trends have transported the world's major economies back to where they stood just before the pandemic: firmly in late-cycle territory.

In Europe, a strengthening recovery has been stifled by the war in Ukraine. Even as the war reduces growth, it is fuelling inflation. And in China, a resurgence of COVID and lockdown policies are eroding growth in that economy.

In the US, tight labour markets are magnifying mounting wage pressures, inflation is soaring and the Federal Reserve is tightening policy. And with supply chain disruptions lingering and costs rising, corporate profit growth has been slowing. Indeed, the US economy contracted 1.5% in the first quarter.

Are we headed for recession? The risk is clearly rising, says US economist Jared Franz, but much will depend on labour markets and the Fed's resolve to aggressively reduce inflationary pressures.

"Late cycles are not predictive of recessions, but they do tell you that the economy's ability to bounce back from shocks is reduced," Franz says. "The environment is changing rapidly and significant headwinds have emerged. I view this as a time to pursue all-weather portfolios built to withstand a variety of risks."

Sources: Capital Group, FactSet. GDP data are in USD and are the latest available as at 31/3/2022. Country position within the business cycle are forward-looking estimates by Capital Group economists as at June 2022, shown for illustrative purposes only.

Expect more volatility as central banks fight inflation

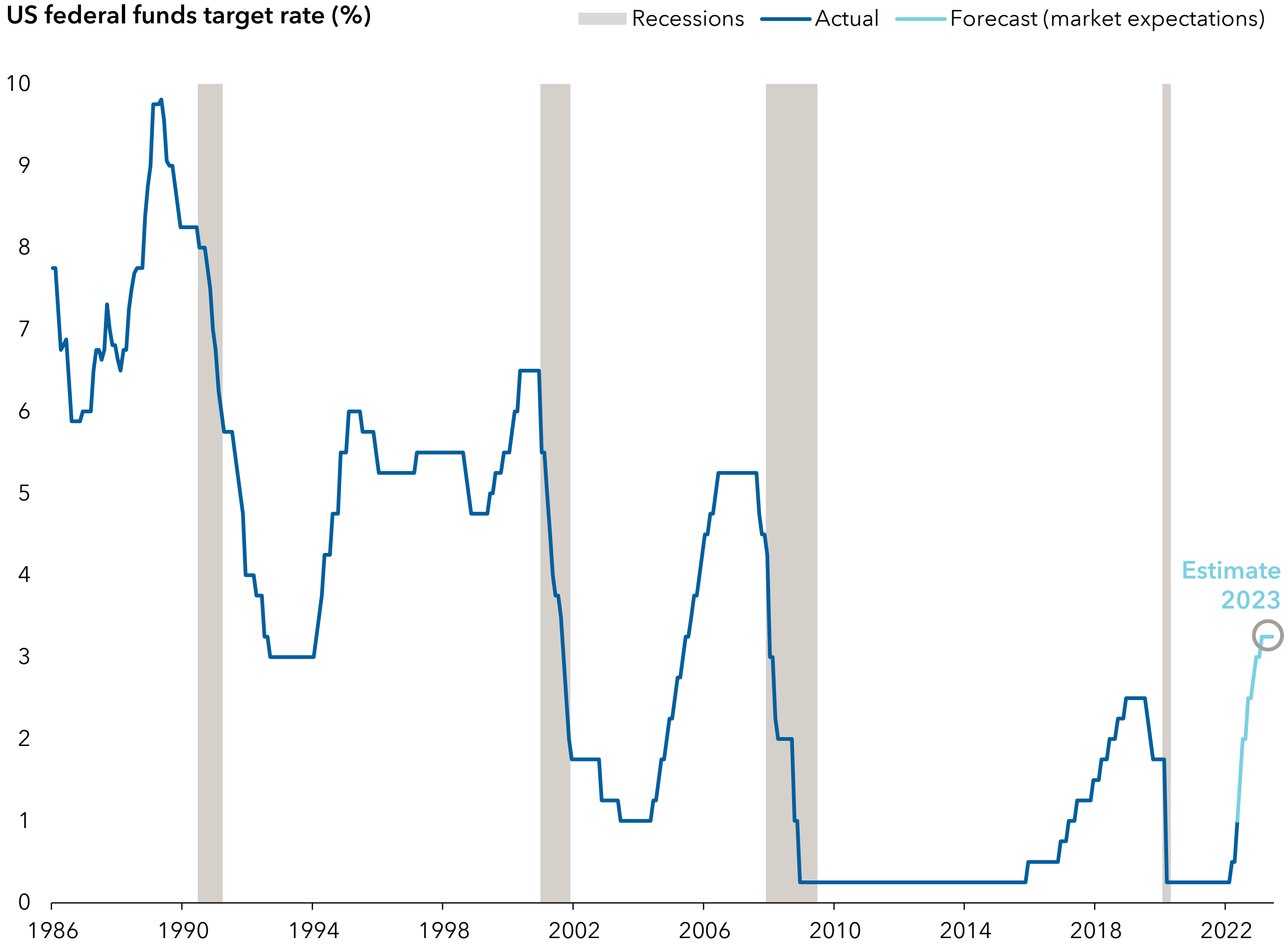
Sharply higher inflation has prompted major central banks to raise interest rates. But how high will they go? Will soaring consumer prices force central bankers to tighten monetary policy beyond current expectations? Or will they back off as higher rates start to take a toll on the economy?

In the past, central banks have stepped in to help alleviate financial market stress. But Fed officials may not have that kind of flexibility anymore, with inflation running at a 40-year high. Also in Europe where growth prospects are more uncertain than in the US, the European Central Bank appears much more concerned about the upside risks to inflation than the downside risks to growth. As such it will continue to tighten later in 2022 and into 2023, unless there is a severe growth shock and/or a more rapid fall in inflation.

"We are seeing a significant deviation from the standard Fed playbook we've become accustomed to over the past few cycles," says Tim Ng, a fixed income portfolio manager at Capital Group. "And the reason is clear: Inflation is far too high." Investors should brace for a bumpy ride, Ng explains, as the Fed and other central banks grapple with how to bring down inflation without pushing the global economy into recession. It may not be possible to do both.

Over the Fed's last three rate-hiking periods, the average time between the first rate increase and the start of a recession was 38 months.

US federal funds target rate (%)



Sources: Capital Group, Chicago Mercantile Exchange, Federal Reserve Bank of St. Louis, National Bureau of Economic Research. Upper bound of target range is used since 2008. Actual data and market expectations, shown for illustrative purposes only, are as at 15/6/22.

European economy growing despite headwinds

The European economy is holding up remarkably well despite investor worries about a war-induced recession as the Russia-Ukraine conflict rages on. While the European manufacturing sector has been hurt by the war and fears that Russia may cut off natural gas supplies, the services sector has done much better, driven primarily by pent-up demand.

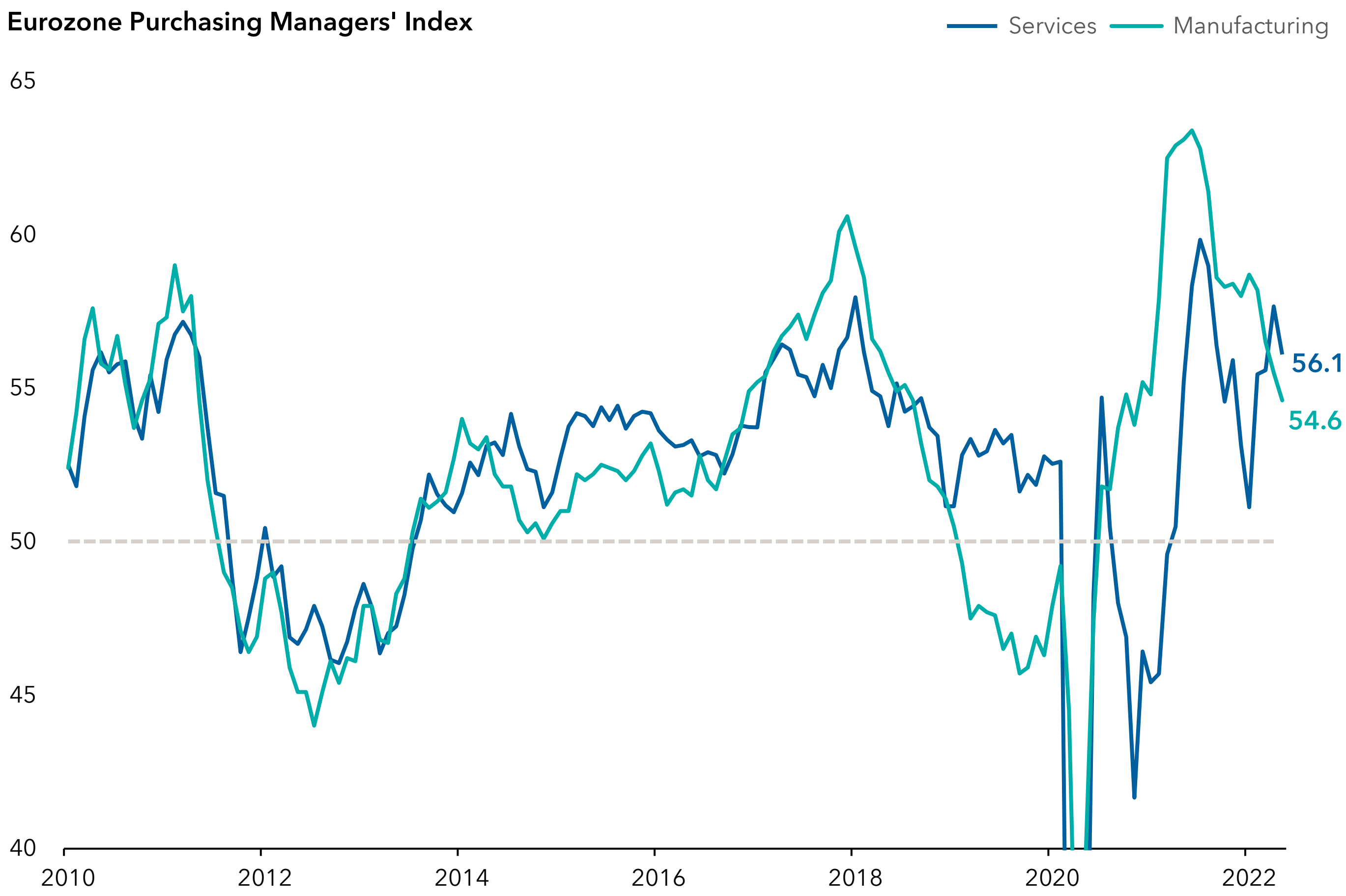
"There's still a reasonable degree of momentum in the European economy," says European economist Robert Lind. "That's a reflection of the reopening trends we saw at the turn of the year as governments started to ease pandemic-related restrictions."

The services sector – which includes finance, retail and tourism, among others – accounts for the bulk of employment and economic output in the eurozone, Lind notes. If current trends persist, that means Europe could continue growing even amid weakness in the manufacturing sector.

Lind expects gross domestic product (GDP) growth in the eurozone to fall within a range of 2.5% to 3% this year. That would represent a strong expansion relative to the eurozone's average GDP growth rate of roughly 1% over the past decade.

Solid economic growth and coupled with high inflation means the European Central Bank has confirmed its intention to hike interest rates in July, Lind says. The ECB's key policy rate now stands at –0.50%. Just two hikes of 25 basis points would effectively end the era of negative interest rates in Europe – a major milestone.

Services sector bolsters eurozone economy as manufacturing slows



Sources: Bloomberg, S&P Global. As at May 2022. The Eurozone Purchasing Managers' Index (PMI) is a measure of business activity compared to the previous month, based on a survey of around 5,000 companies based in the euro area manufacturing and service sectors. PMI levels above 50 indicate growth and levels below 50 indicate contraction. In 2020, the Services PMI declined to 12.0 and the Manufacturing PMI declined to 33.4, but are not shown on the chart for scale.

Japan's roadmap to a green and digital future

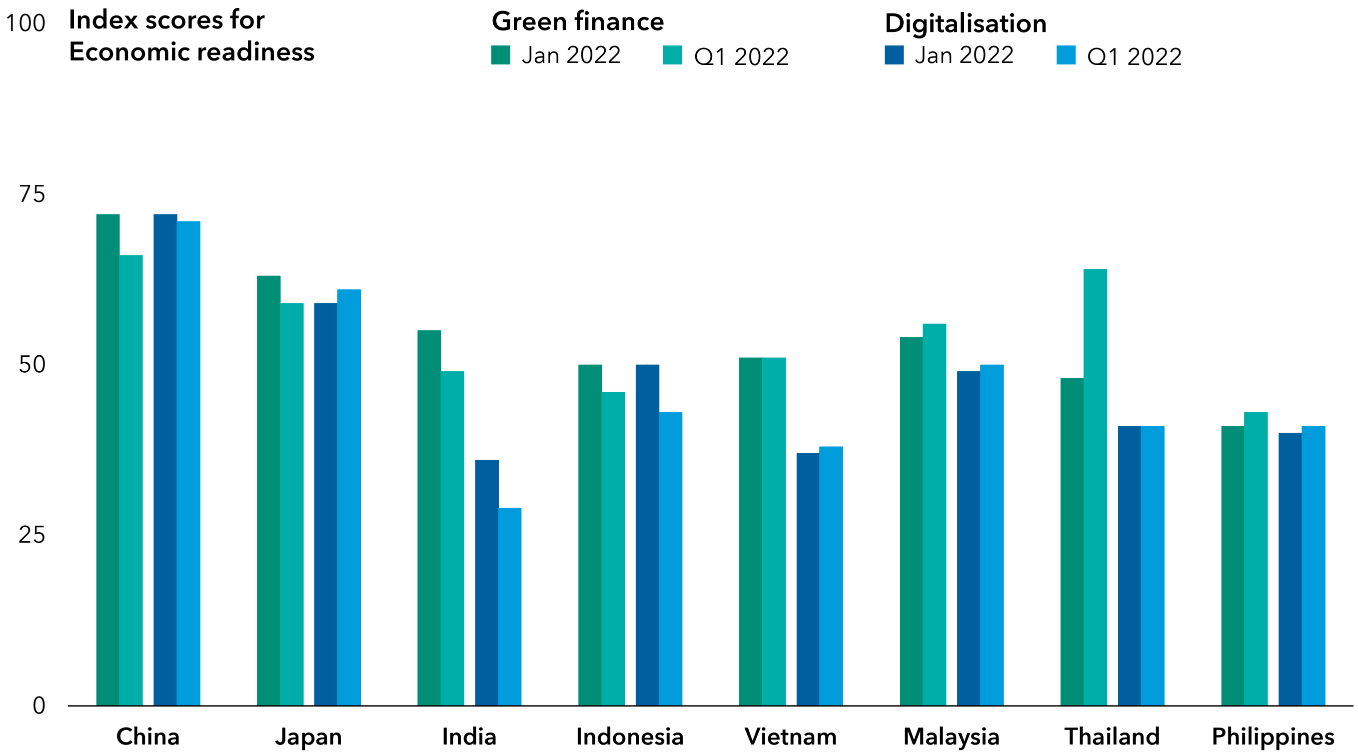
A 10-year green plan and issuance of green transition bonds (worth 20 trillion yen) are some of the recent pledges made by Prime Minister Kishida. His words were delivered with a sense of resolve as resource-poor Japan grapples with the need to reduce its heavy dependency on fossil fuels and achieve carbon neutrality by 2050.

Much is at stake when Japanese consumers are starting to feel the pinch of rising energy prices amid lacklustre real wage growth. Both of which could influence voters' sentiment ahead of the July upper house election. Importantly, public support for the Kishida administration is at an all-time high as many Japanese voters are in favour of the government's handling of the pandemic and its diplomatic affairs. Success at the upper house election would provide Prime Minister Kishida with sufficient time to fulfil his policy agenda.

On the digitalisation front, medium- and high-tech manufacturing, along with information and communications technology import demand, lifted the nation's digital readiness score over Q1 2022.[1] Japan's digital competitiveness position still has room to grow as its ranking pales in comparison to its developed counterparts such as the US, Hong Kong and Sweden.[2]

Many of the products and services developed by Japanese companies are deemed crucial to the digital transformation we are witnessing. As Japan's digital infrastructure improves and its economy continues to digitalise, its organisations could play a bigger and more important role in the world of tomorrow.

Japan's economic readiness readings have been supported by an accommodative monetary policy, expansion in domestic credit and resilient foreign direct investment[1]



Green transition bonds: A new type of debt instrument to finance companies' efforts in reducing carbon emissions.

1. Asia House's Economic Readiness Indices (scored out of 100) measure each country's progress in macroeconomic readiness in green finance and digitalisation. Source: Asia House Research
2. IMD World Digital Competitiveness Ranking 2021. Source: International Institute for Management Development (IMD)

The environment has dominated investor focus, but awareness of social and governance issues is rising

Structural and societal pressures arising from climate change have driven the environment – the E in ESG – to the top of investors' sustainability focus. However, social and governance issues are gaining greater traction, particularly as the war in Ukraine raises significant ESG concerns.

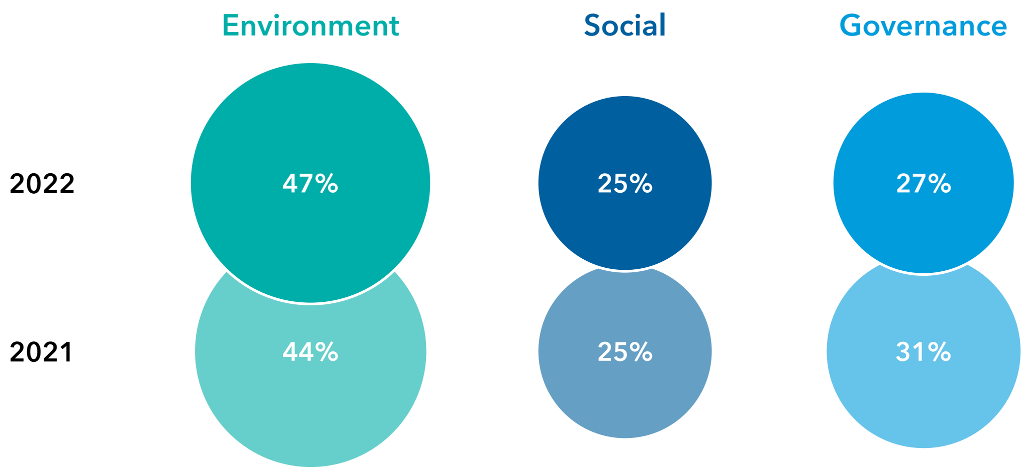
Even before the Russia-Ukraine conflict, there was evidence of broadening investor interest on ESG topics. Capital Group's ESG Global Study gathered views from 1,130 global investors in early 2022. The study showed that the environment continued to dominate allocation decisions, with investors increasing their focus on this from the year before (47% vs. 44%). However, there were signs that this may change in the future as people recognise an imbalance. When asked whether social issues are being overlooked, 41% of investors agreed. This suggests that ESG interests are moving beyond a narrow focus.

The situation in Russia-Ukraine brought ESG issues further into the spotlight, particularly around governance. The global response to Russian aggression was not just political; the corporate sector was quick to take a stance. At Capital Group, we follow company actions closely, looking behind corporate statements to understand the impacts and how companies' licence to operate may be affected. While much of the media focus was on public announcements, we paid particular attention to companies that had not made public statements.

Momentum behind sustainable investing continues to build. Investors' awareness of ESG topics is not just increasing, we believe it is also broadening to cover a wider range of social and governance issues.

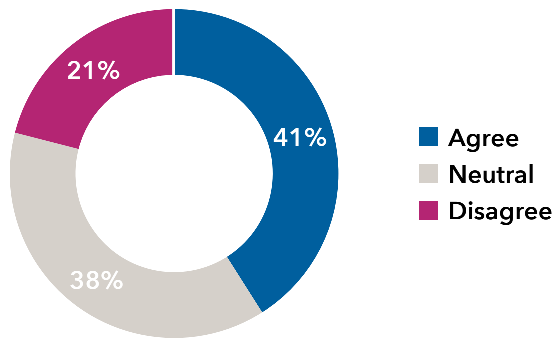
The E of ESG continues to dominate investor allocations

What percentage of your ESG focus is, or would be, allocated to these three segments?



Despite 40%+ recognising social issues are being overlooked

To what extent do you agree or disagree that social issues are being overlooked in the debate on climate change?



Source: Capital Group, ESG Global Study 2022, via an extensive online survey conducted by CoreData Research between February and March 2022

Stock markets have weathered previous rising-rate periods

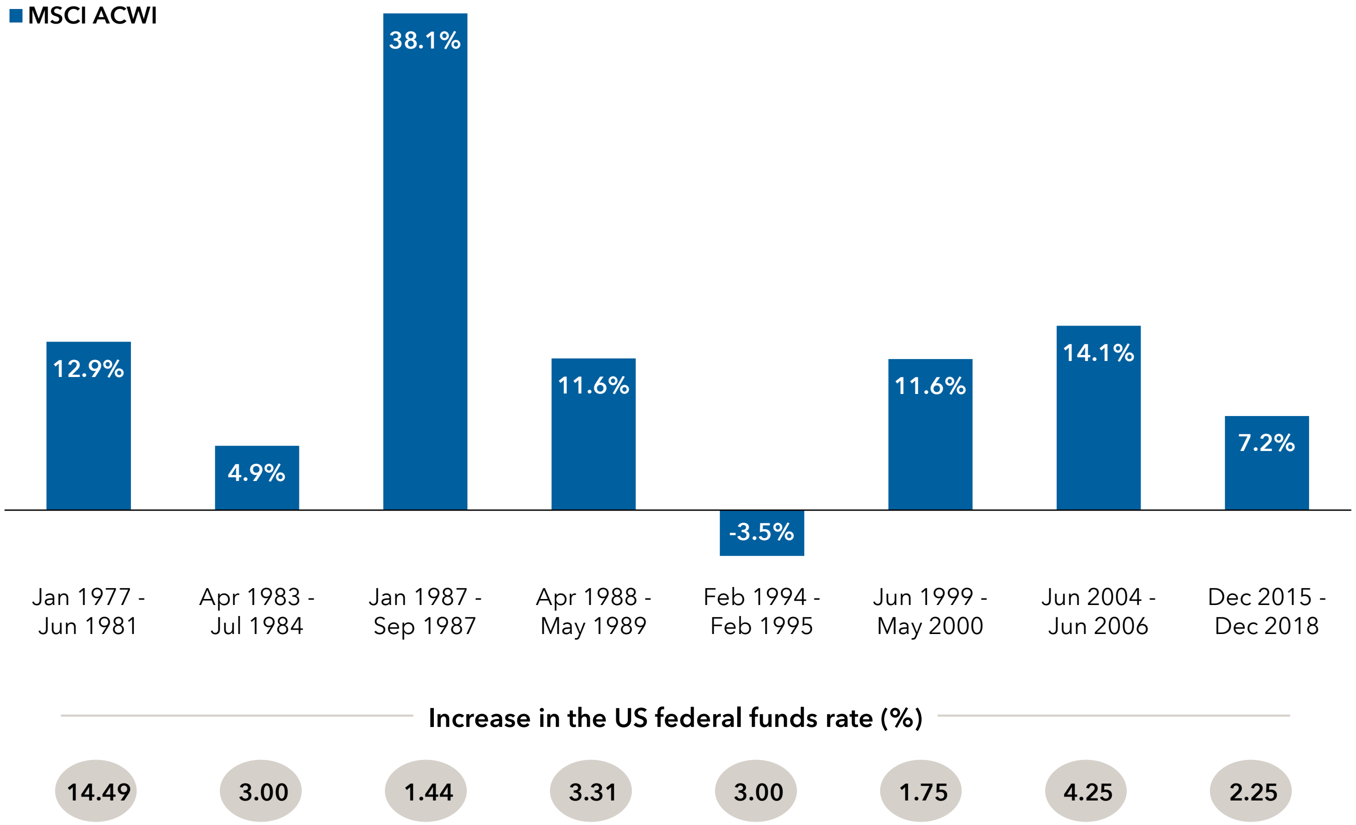
Rates may be on the rise, but history shows returns could be looking up as well. In the eight rate-hiking periods since 1977, the MSCI ACWI has posted an average annualised return of 12.1%.

But with volatility elevated and the implications of the rate cycle unknown, investors may want to own an "all-weather" portfolio. Attractively valued companies that have demonstrated the ability to thrive regardless of the economic environment can be especially important right now.

"I generally don't pay too much attention to macro, unless we're at inflection points where I think it really matters. Now feels like one of those points," says equity portfolio manager Diana Wagner. "In a world where growth may be scarce, I prefer companies that have a demonstrated track record of making their own growth happen – companies with a high return on equity, low commodity input costs and strong pricing power."

Wagner notes that beverage companies could provide both defensive and offensive attributes in today's market. Keurig Dr Pepper, for example, has a razor and blade business model (starting product at a low cost, with the sale of related products later on) with its single-serve coffee pod distribution, in addition to a growing soft drinks segment. Other companies that have exhibited all-weather attributes in the past include Microsoft, Nestlé and insurer Marsh & McLennan.

Equity returns during rising interest rate environments



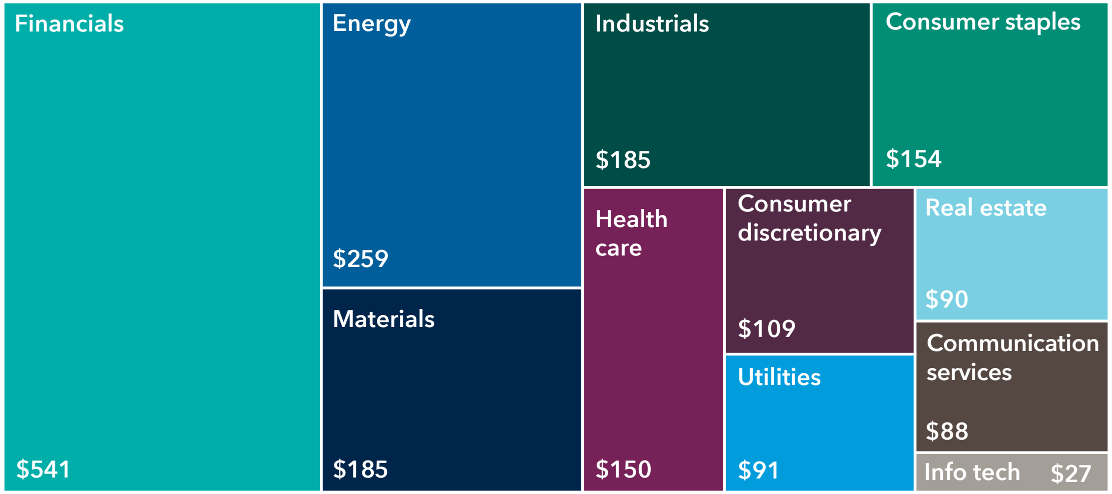
Past results are not a guarantee of future results.

Sources: Capital Group, MSCI, Refinitiv Datastream, US Federal Reserve. MSCI ACWI returns represent annualised total returns in USD terms. MSCI ACWI is a free float-adjusted market capitalisation-weighted index designed to measure equity market results of developed and emerging markets. MSCI World (net) returns shown prior to 31/12/1987 and MSCI ACWI (net) returns shown thereafter.

Rising dividends can counter inflation

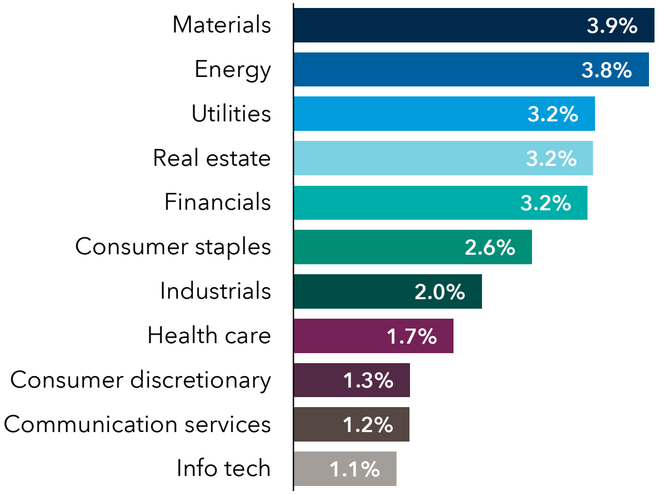
Global dividend payments rose 20% to US$1.9 trillion in the last year…

Dividends paid by MSCI ACWI last 12 months (USD billions)



…and attractive yields can be found across sectors.

Dividend yield (MSCI ACWI)



When market volatility is rising, boring is beautiful. That's why many dividend paying stocks today are compelling, if dull and dependable, investment opportunities.

Global companies paid out a remarkable $1.9 trillion for the 12 months ended 31 May 2022, as measured by the MSCI ACWI (All Country World Index). That represents a 20% jump from the prior 12 months.

"In this low-growth, inflationary environment, I am focusing on companies with manageable debt and sustainable dividends," says Caroline Randall, an equity portfolio manager. "We are finding many across a range of sectors that are increasing dividends 10% a year."

Proven dividend growers can help bolster investment returns when inflation is rising. "I look closely at what companies actually do with their dividend, rather than just what they say they will do," says Randall. "Dividend growth commitments are a critical signal by management about their confidence in the future earnings growth potential of their company."

Companies paying growing dividends can be found across the financials, energy, materials and health care sectors, among others.

Past results are not a guarantee of future results.

Sources: Capital Group, MSCI, Refinitiv Datastream, Refinitiv Eikon, RIMES. Dividends paid represent total cash dividends in the trailing 12-months as at 31/5/2022. Dividend yield is for MSCI ACWI as at 31/5/2022. MSCI All Country World Index (ACWI) is a free float-adjusted market capitalisation-weighted index designed to measure equity market results in the global developed and emerging markets, consisting of more than 40 developed and emerging market country indexes.

Mining companies look undervalued amid soaring commodity demand

You can't build the new economy without old companies.

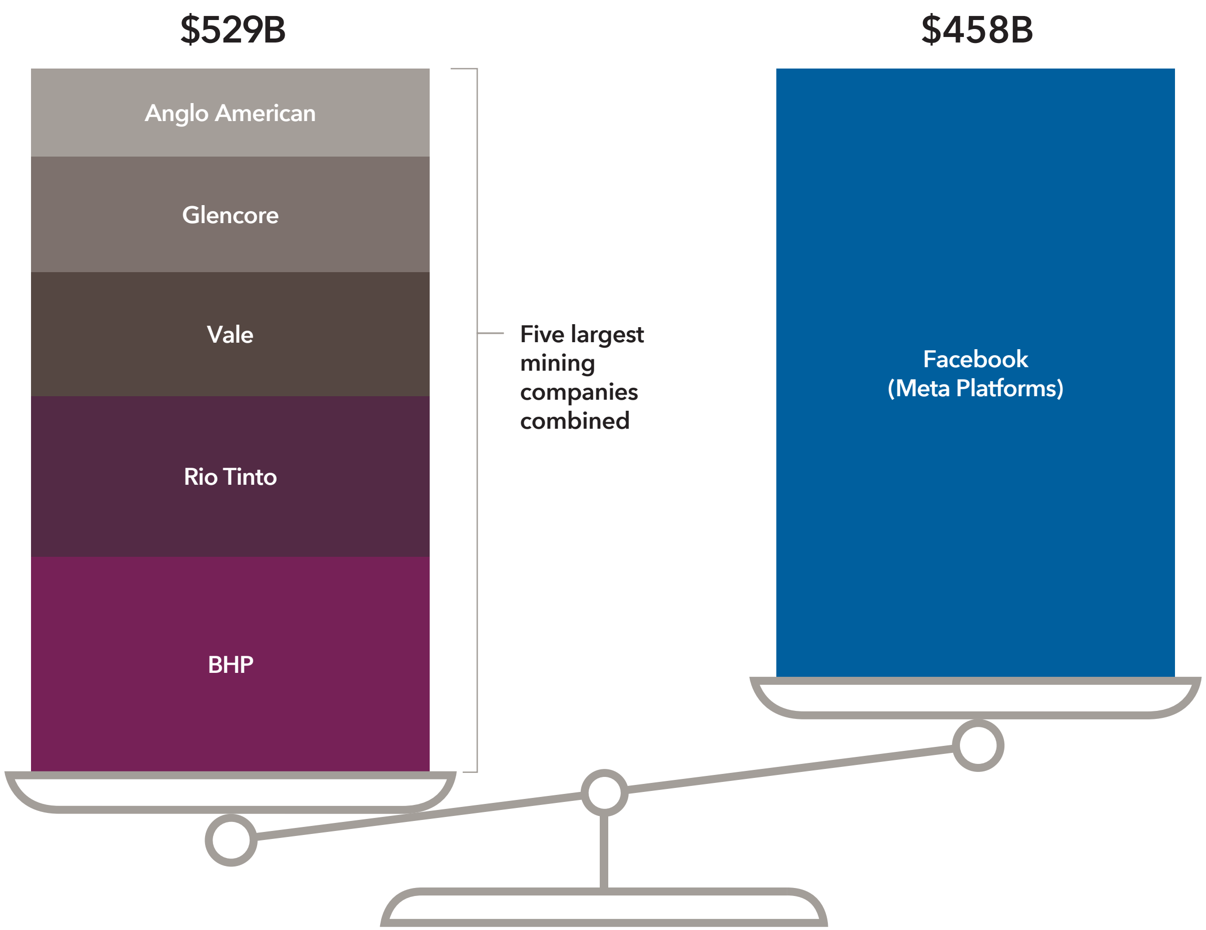
Case in point: The mining industry, a long-neglected corner of the equity markets, suddenly looks a lot more attractive. With commodity prices skyrocketing, companies that produce basic materials such as iron ore, copper and nickel have gained renewed attention given the crucial role they play in the global economy.

"Investors are starting to embrace companies that produce tangible assets," says portfolio manager Carl Kawaja. "For instance, nickel and copper are key components in the production of electric vehicles. We all know how rapidly EVs are growing, but I think people underappreciate the extent to which you still need a lot of nickel and copper to build them."

Some commodity prices could remain high for years due to chronic underinvestment in new mining projects and the extended length of time it takes to launch them. That dynamic remains largely unrecognised by the market.

Look at the market capitalisation of the world's five largest mining companies. Combined they barely exceed the value of Facebook parent Meta Platforms. Iron ore, a key ingredient in steel, is another good example. "I'm not really worried about Silicon Valley disrupting the iron ore industry," Kawaja says. "It's been around since the Iron Age. That's an enduring business."

Market value of five largest mining companies vs. Facebook (USD)



Source: RIMES. As at 31/5/22. Facebook data is the market value for the entire company, which was renamed Meta Platforms in 2021.

US health care, with promising drug pipelines, looks attractively valued

All eyes were on the health care industry during the early days of COVID, and drug developers thrived under the spotlight, producing vaccines and therapies in record time.

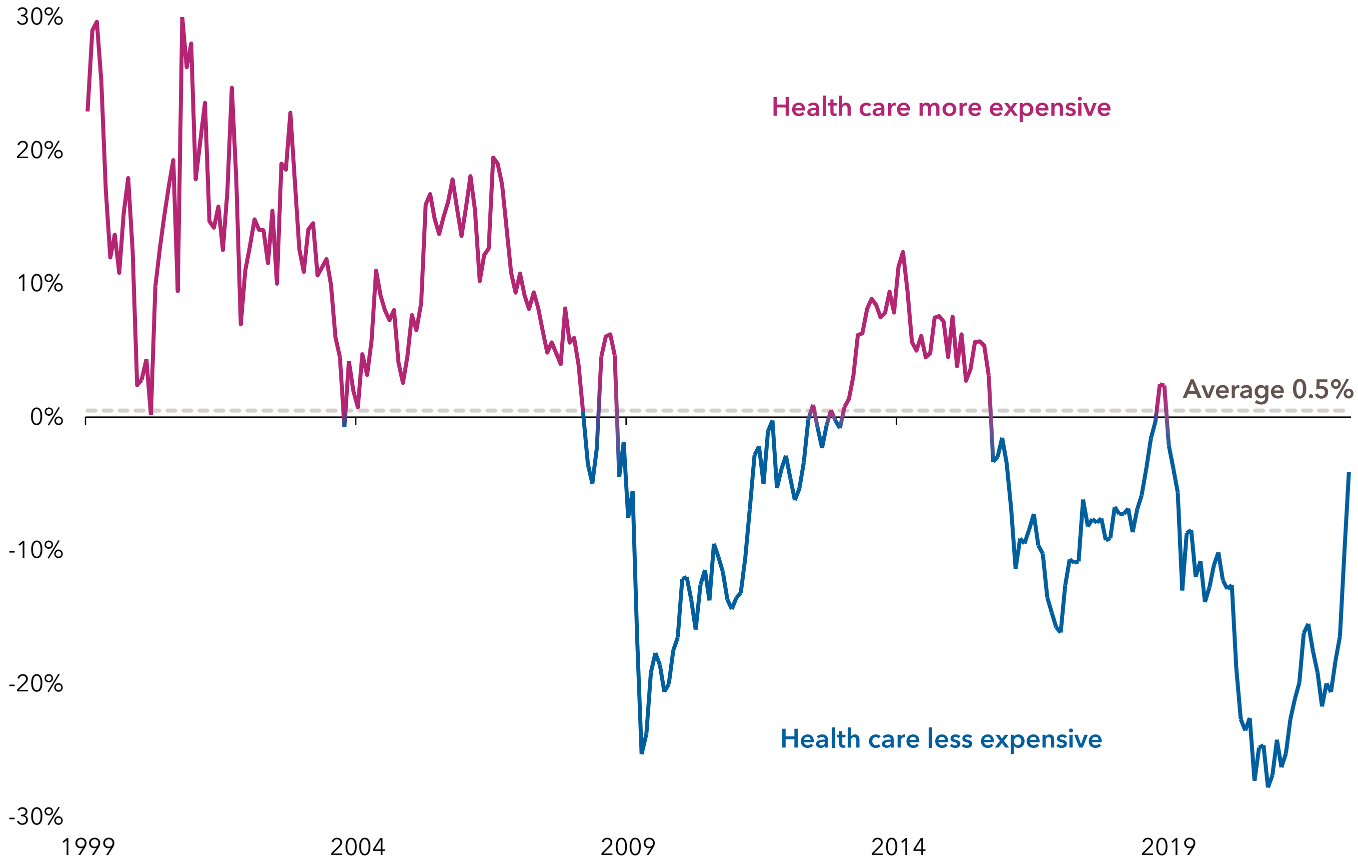
Despite the attention, many observers may have overlooked that health care companies appear attractively valued relative to the broader stock market and their own history. “Some market leaders are particularly appealing, given the prospects for growth of their pipelines,” says equity portfolio manager Alan Wilson.

Across the global health care sector, drug developers, device makers and service providers are transforming health care and improving patient outcomes.

“We’ve seen the potential of the power of personalised medicine,” adds Wilson. “Drug discovery is in a golden age that would not be possible without the combination of efficient genetic sequencing, computational power to analyse massive datasets and precise biochemical tools.” One recent advancement is antibody-drug conjugates (ADCs) which empower the immune system to target cancer cells while leaving healthy cells alone.” The global market for such treatments is expected to grow from US$3.18 billion in 2020 to US$20.01 billion in 2028.

For example, oncology pioneers Bristol Myers Squibb, Merck and Roche are developing ADCs that combat various tumours. Of, course not every ADC will be a success, so the key for selective investors is to understand both the science and business opportunity.

Relative valuation of health care sector to MSCI USA



Past results are not a guarantee of future results.

Sources: Refinitiv Datastream, MSCI. Relative valuation is the ratio between the forward 12-month price-to-earnings ratio of the health care sector of the MSCI USA Index to the overall MSCI USA Index. MSCI USA Index is a free float-adjusted, market capitalisation-weighted index designed to measure the US portion of the world market. As at 31/5/2022. Price-to-earnings is the ratio of a company’s share price to its earnings per share.

Technology stocks are down, but cloud growth remains sky high

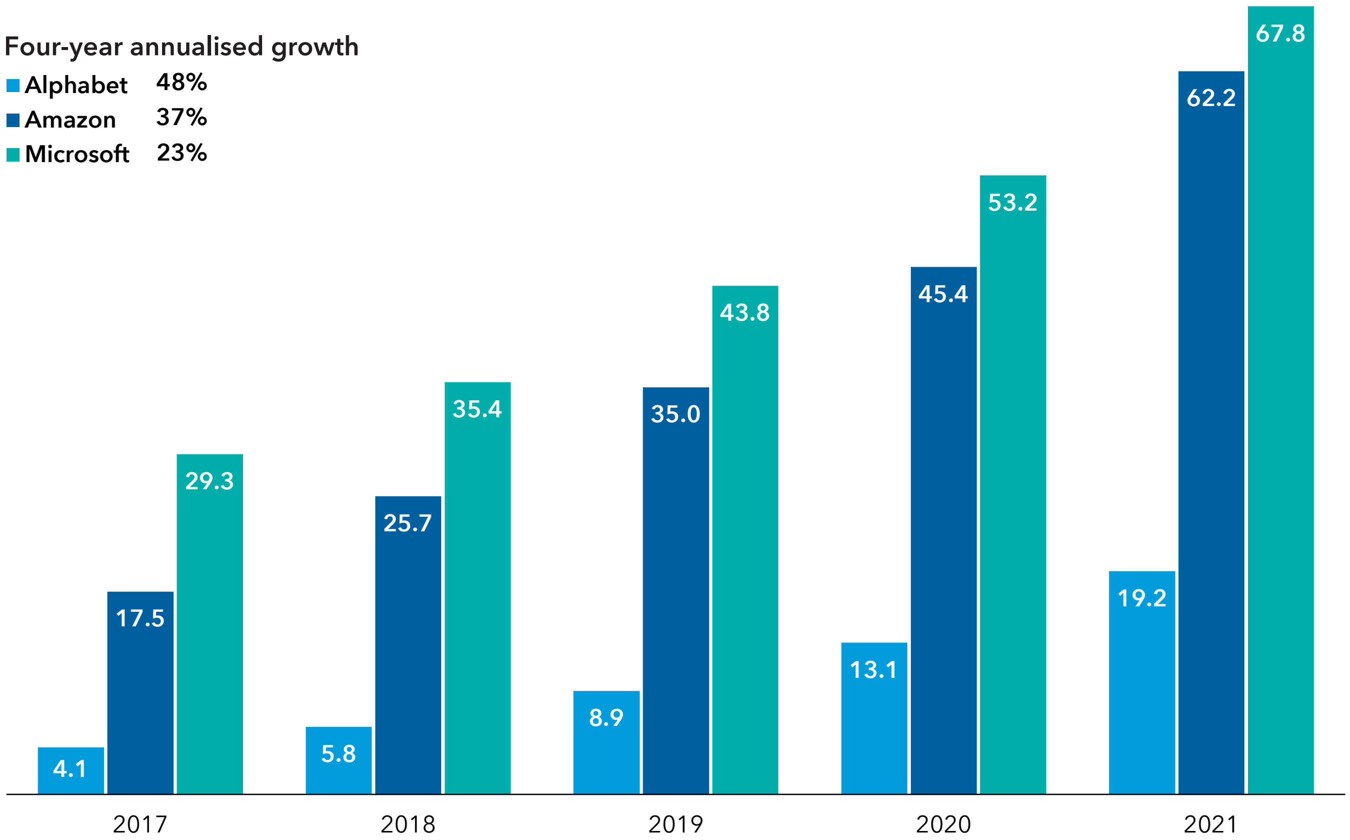
Technology stocks hit a brick wall during the first half of 2022, leading some investors to wonder if the digital revolution has run its course.

Not likely, according to equity portfolio manager Chris Buchbinder. “Rising interest rates and inflation have certainly clouded the longer term earnings picture for many of these companies. For those with limited earnings today relative to their market values, the pullback was warranted,” Buchbinder explains. “But I believe there are also well-run software companies in fast-growing segments with favourable prospects.

The cloud services business, as an example, has rapidly expanded as businesses move their traditional enterprise IT functions to the cloud. “A few years ago, when Amazon Web Services was introduced, it was really a new business segment,” Buchbinder says. “It’s no longer new, but we are still in the early days of this transition.”

Microsoft was not the first mover in this market, but it is growing faster than AWS and Google Cloud thanks to its strong legacy enterprise relationships. As of April 2022, the cloud services division of Microsoft achieved 32% quarterly growth from a year earlier, putting it on a path to reach nearly US$100 billion in annual revenue. “It is not a certainty that all cloud businesses will realise the profit growth to justify high valuations,” Buchbinder says. “That is why selective investing through fundamental research is essential.”

Cloud revenue across major cloud computing service providers (USD billions)



Past results are not a guarantee of future results.

Sources: Capital Group, company filings, Refinitiv Eikon. Years above refer to calendar years. Cloud revenue is represented by segment revenue for Intelligent Cloud Services (Microsoft), Amazon Web Services (Amazon), and Google Cloud (Alphabet). Data as at 31/12/2021.

After big bond declines, history suggests better days ahead

There's no sugar coating it – early 2022 was not a great time for bonds. The Bloomberg Global Aggregate Index, was down 11% through to May, one of the worst starts to a calendar year in recent history. The highest inflation in decades thrust major central banks into hawkish mode. But current bond prices now reflect that pain.

During and after hiking periods, more yield helps boost returns. Looking at the US, this is part of the reason hiking periods realised an average return of 2.3% for the Bloomberg US Aggregate Index. Then there's the recovery: The first and second year after those periods saw average returns of 13.2% and 12.6%, respectively.

"We do not expect yields to continue to rise like they have since mid-2021," says Ritchie Tuazon, a fixed income portfolio manager. Futures markets indicate that investors expect US Treasury yields across the spectrum from two- to 10-year maturities to rise between 10 and 40 basis points over the next year. Consider a hypothetical example based on the interest rate exposure of the Bloomberg US Aggregate Index. Even if rates rise a full 40 basis points across the Treasury curve during that period, the increased yield would overshadow the loss in price return to produce a modest positive total return, Tuazon explains.

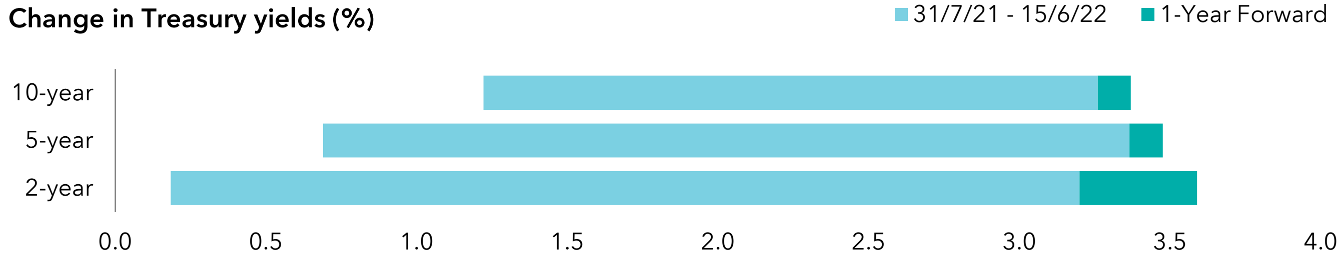
"We're in a late-cycle economy when persistent inflation and other factors could translate to more fierce equity volatility," Tuazon says. "Now isn't a time to shy away from maintaining a strong core bond allocation for diversification."

The bond market has historically weathered rate rises

		US Aggregate annualised return (%)		
Fed rate hike dates and magnitude	(%)	Rising rate period	First year after hikes	Second year after hikes
Jan 1977 - Jun 1981	14.49	2.0	13.3	30.2
Apr 1983 - Jul 1984	3.00	5.8	23.9	21.5
Jan 1987 - Sep 1987	1.44	-2.9	13.3	11.3
Apr 1988 - May 1989	3.31	8.7	9.4	12.5
Feb 1994 - Feb 1995	3.00	-1.6	17.1	3.3
Jun 1999 - May 2000	1.75	1.4	13.7	7.7
Jun 2004 - Jun 2006	4.25	2.8	6.5	7.0
Dec 2015 - Dec 2018	2.25	2.0	8.8	7.2
Average		**2.3**	**13.2**	**12.6**

Much of the Fed's rate moves are already priced in

Change in Treasury yields (%)



Past results are not a guarantee of future results.

Sources: Capital Group, Bloomberg, Bloomberg Index Services Ltd., RIMES, US Federal Reserve. Data as at 31/5/2022 in USD terms. In the bond maths example above, we consider the duration and yield-to-worst of the Bloomberg US Aggregate Index on 15/6/22 of 6.44 years and 3.96%, respectively. Duration is a measurement of interest rate sensitivity where for each year of duration a 1% increase in interest rates leads to a 1% price loss. In this example 40 basis points, or 0.4%, higher rates across the Treasury yield curve would lead to a 2.58% price loss (6.44 x 0.4%). In this hypothetical example, shown for illustrative purposes only, that loss would result in a net gain of 1.38% over the course of the year due to earning yield income (–2.58% + 3.96%).

Income is returning to fixed income

The ultra-low interest rate environment of the pandemic era gave way to a jarring reality: Markets don't react well to rising rates. Painful short-term losses, however, could lay the groundwork for more income.

Yields on bonds have risen sharply since the lows experienced in recent years. Yields, which rise when bond prices fall, have jumped across bond sectors as central banks seek to quash inflation. Over time, rising yields mean more income from bonds.

At today's yields, history suggests higher total returns over the next few years. The total return on a bond is the function of price changes and interest paid – and interest is rising.

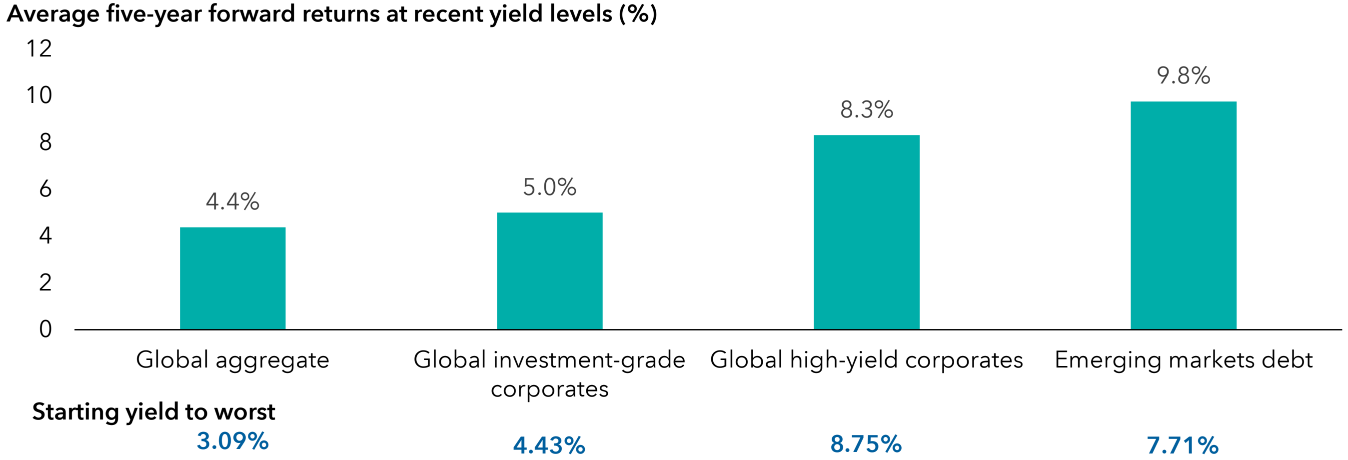
Investors could benefit from holding bonds across fixed income asset classes, including high yield. "Average annual returns for the US high yield market historically are approximately 6% to 8%. We are again at a starting yield level where these returns could be achieved, with a multi-year investment horizon, which is the first time this has been true in a while," says fixed income portfolio manager Tara Torrens. "However, the path from here to there could be very bumpy."

There are also opportunities in emerging markets debt – a corner of the bond market that has been especially volatile. Several countries have raised rates ahead of the Fed and are on good financial footing, according to fixed income portfolio manager Rob Neithart. Given the nuances of emerging markets investing, an active approach can help steer investors toward select investment ideas.

Bond yields have climbed as rates jumped

Yields of key fixed income markets (%)	Recent low	15 June 2022	Difference
Global aggregate	0.80	3.09	**2.29**
Global investment-grade corporates	1.34	4.43	**3.09**
Global high-yield corporates	4.12	8.75	**4.63**
Emerging markets debt	4.36	7.71	**3.35**

Higher yields have boosted total returns



Yields as at 15/6/22. Returns as at 31/5/22 in USD terms. Sources: Capital Group, Bloomberg. Data goes back to 2000 for all sectors except for emerging markets debt, which goes back to 2003. Based on average monthly returns for each sector when in a +/- 0.30% range of yield-to-worst. Sector yields above include Bloomberg Global Aggregate Index, Bloomberg Global Aggregate Corporate Index, Bloomberg Global High Yield Index, 50% J.P. Morgan EMBI Global Diversified Index / 50% J.P. Morgan GBI-EM Global Diversified Index blend.

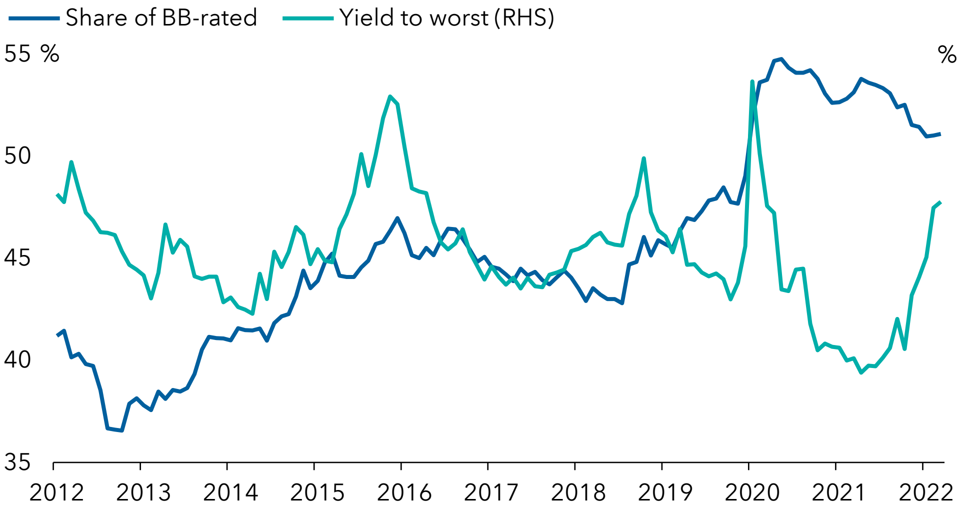
Past results are not a guarantee of future results.

Sources: Bloomberg, Bloomberg Index Services Ltd., J.P. Morgan. For top chart: Period of time considered from 2020 to present. Dates for lows from top to bottom in chart shown are: 4/8/2020, 31/12/2020, 6/7/2021, and 4/1/2021 respectively.

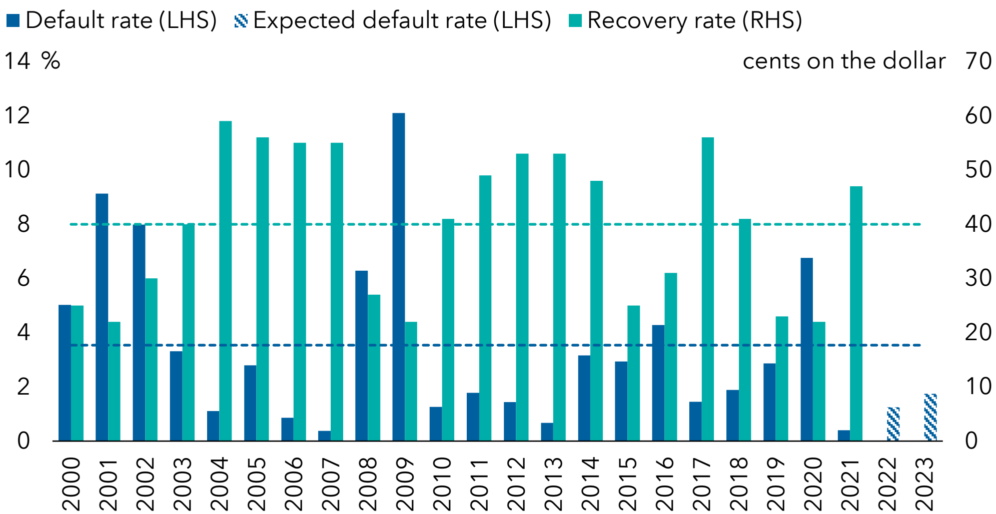
Attractive valuations, but selectivity remains key

High yield fundamentals have been improving

Improved credit quality and higher yields



High yield already endured a big default cycle in 2020



Although high yield bonds have also been affected by the global market sell-off this year, they did better than most other areas of the fixed income market, primarily as a result of their lower sensitivity to interest rate rises. This lower sensitivity could also continue to help insulate it against further interest rate driven volatility.

However, against a backdrop of high volatility, slowing growth and an uncertain outlook there have understandably been worries about how well the asset class could perform in a slowing growth, or even recessionary, environment.

High yield could still do well in a slowing growth environment. The overall profile of the market has changed over the last few years with higher quality bonds making up a higher proportion of the market. It is also bigger and more diverse than it previously was.

Following a spike in default rates as a result of the damage inflicted by the pandemic, they returned to very low levels in 2021. Going forward there are good reasons to believe the default rate will remain low.

Firstly, a lot of the lower quality bonds that were at risk defaulted during the pandemic and many of the surviving companies are still in good shape. As previously mentioned the overall quality of the market is higher, and in the recent past many of the defaults were in commodity-related sectors. The current backdrop is more supportive of these issuers.

At higher yields the asset class is looking attractive from a historical perspective. However, caution is still warranted and selectivity remains key.

Past results are not a guarantee of future results.

Source: Bloomberg Index Services Ltd. As at 31/5/2022. Bloomberg US High Yield Corporate 2% Issuer Capped Index. RHS chart: Shaded bars represent JPMorgan forecasts, shown for illustrative purposes only. High yield: lower quality bonds rated BB or below.

A more constructive outlook for corporate bonds, but caution is still warranted

It has been a difficult start to the year for investment grade corporate bonds, which returned -16.1% year to date. As inflation jumped to the highest levels seen in decades in developed markets, major central banks have turned increasingly aggressive in their attempts to control it, gradually removing stimulus measures and raising interest rates. This has caused interest rate sensitive bonds, such as investment grade corporates, to sell-off. The Russia-Ukraine conflict has also contributed to an overall very volatile macroeconomic environment. As a result of the drastic revaluation, though, there is now arguably a much more attractive entry point for investors in investment grade corporate bonds.

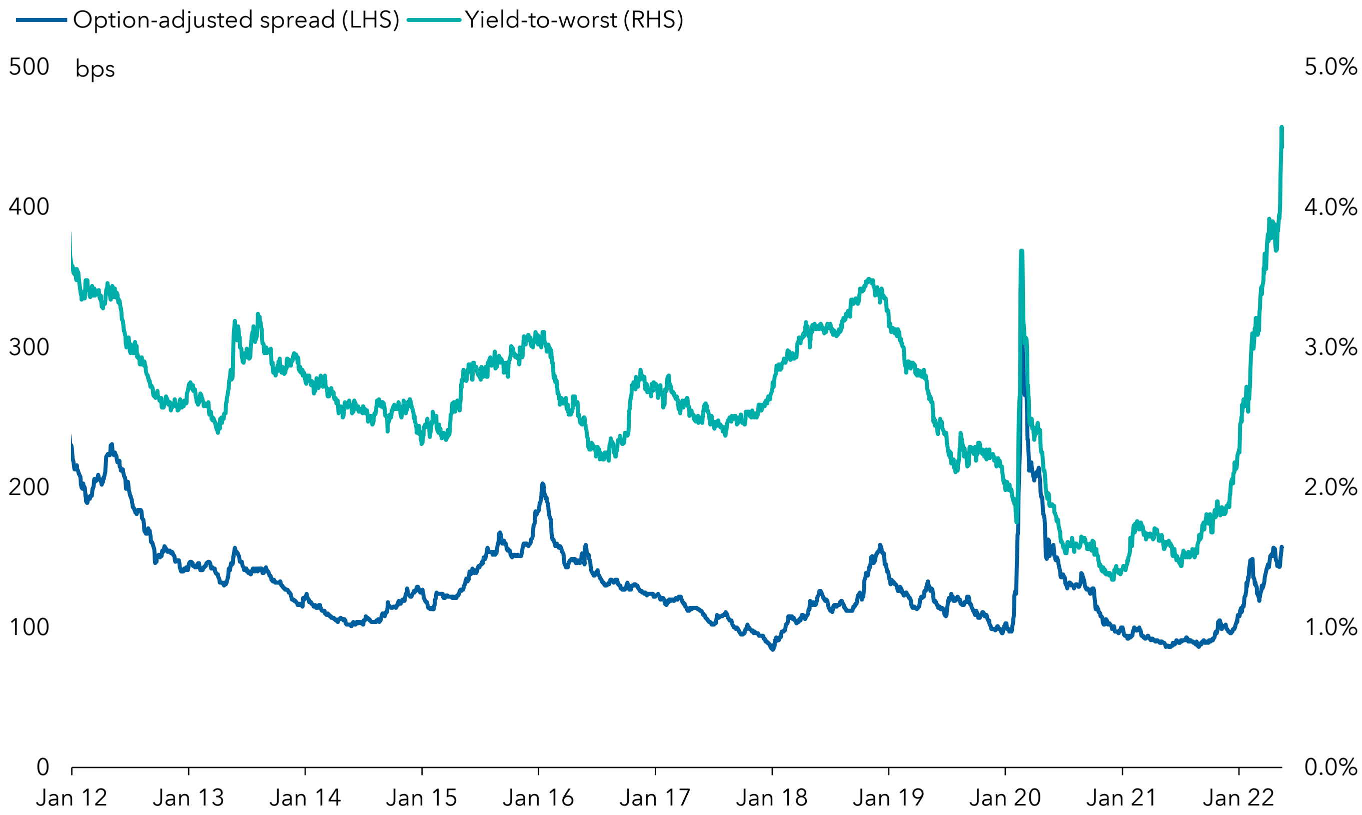
Yields have reached levels not seen in more than 10 years although this was mostly driven by the rise in interest rates rather than spreads, which represent the perceived credit riskiness of bonds. At these higher yields investors now have the potential to earn more income from bonds. Higher income can also offer more cushion for total returns over time, even if price movements remain volatile.

Companies also generally remain in good shape from a fundamental point of view. They continue to display healthy revenues and profit margins despite a higher inflationary and slowing growth environment.

The current macroeconomic environment, however, remains highly volatile and an overall cautious and slightly defensive stance is still warranted. Careful selection in companies and sectors remains key.

More attractive valuations could present a good entry point for investors

Spreads and yields



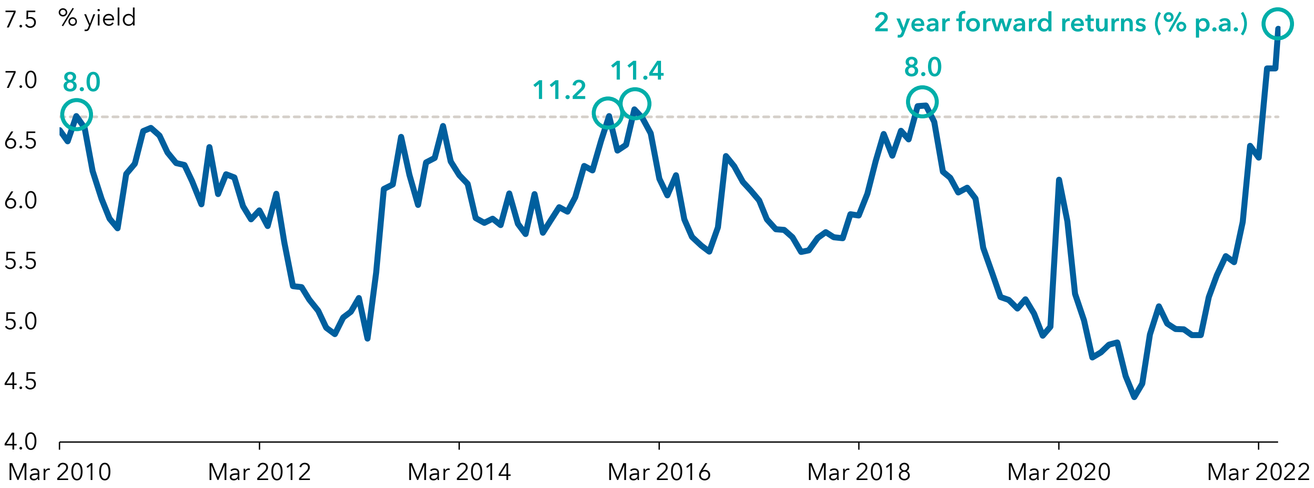
Past results are not a guarantee of future results.

Source: Bloomberg Index Services Ltd. As at 15/6/2022. Returns presented in USD terms (unhedged). Index used is the Bloomberg Global Aggregate Corporate Bond Index. The yield-to-worst is the lowest possible return over a particular period of time that can be received on a bond that fully operates within the terms of its contract without defaulting. The option-adjusted spread is the spread that accounts for the embedded optionality of some bonds. Investment grade: higher quality bonds rated BBB or above.

Does the EM debt repricing present a good entry point?

EM yields have risen and fundamentals appear stable

Medium term forward returns when EM yields peaked above 6.7%[1]



Many EMs have aggressively hiked policy rates[2]

%	2020	Current	Change
Brazil	2.00	12.75	**+10.75**
Chile	0.50	9.00	**+8.50**
Poland	0.10	6.00	**+5.90**
Czech Republic	0.25	5.75	**+5.50**
Hungary	0.60	5.90	**+5.30**
Peru	0.25	5.50	**+5.25**
Colombia	1.75	6.00	**+4.25**
Mexico	4.00	7.00	**+3.00**

Emerging market debt is in a relatively strong position to face upcoming challenges. As well as the uncertainty of the Russia-Ukraine conflict, EM faces higher global inflation and a more front-loaded Fed hiking cycle. These challenges should be more manageable for EM than they have been in the past in light of mostly solid fundamentals, supportive technical factors and attractive valuations.

A number of EM central banks, particularly in Latin America, have meaningfully raised interest rates to combat rising inflation. Nominal and real yields appear to provide fair compensation for elevated inflation, which may peak sometime this year. On a relative basis, EM nominal and real interest rate differentials versus developed markets are now at historical averages, while our frameworks show EM currencies to be near secularly cheap levels.

As valuations have broadly corrected to the downside and yields have risen, negative outcomes appear to be at least partially priced into the asset class.

As the chart indicates, historically, 2-year returns have been positive when yields reach 6.7% or higher. The current yield level based on a 50/50 blend of the EM hard and local currency sovereign bond indices stands at approximately 7%. High starting yields can help offset subsequent price volatility.

Past results are not a guarantee of future results.

A real interest rate is adjusted to remove the effects of inflation and gives the real rate of a bond or loan. A nominal interest rate refers to the interest rate before taking inflation into account.

1. Sources: Bloomberg, J.P. Morgan, Morningstar. As at 10/6/2022 in USD terms. Yield-to-worst and forward returns callouts shown are for 50% J.P. Morgan EMBI Global Diversified Index (hard currency) / 50% J.P. Morgan GBI-EM Global Diversified Index (local currency). Callout dates for yield peaks are: 31/5/2010, 30/9/2015, 31/12/2015, 31/10/2018 and 10/6/2022. Forward returns based on annualised returns.
2. Source: Bloomberg. 2020: As at 31/12/2020. Current: As at 13/6/2022.