



ASSET ALLOCATION VIEW

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Asset and Market Survey

Economy — Recovery flagging in Europe and Asia, still strong in US

Leading indicators show the cyclical recovery continuing, but suggest the momentum of the recovery is flagging in Europe, China and elsewhere in emerging Asia. In the US, inventory stocking, consumer spending and the beginnings of capital spending are expected to underpin strong GDP reports for the first and second quarters.

Fixed Income — Positive on high yield

Relative value in this asset class continues to favor high yield. Healthy investor appetites, improving corporate balance sheets and associated rating upgrades are expected to support further, albeit modest, compression of credit spreads over the course of this year.

Equities — Positive on North America, Japan, less so on Europe

While the ongoing recovery in the economy and corporate profitability supports an outlook for continued equity market gains over the next couple of months, further upside potential is modest and risks have increased. Investors now have to be more discriminating/defensive about market and sector exposures. The best developed market returns are expected to come from North America and Japan, while Europe may be held back by jitters about the public finances of Greece and other small European economies.

Emerging Markets — Neutral to positive; wary on China

These markets enjoy the same support factors as equities in general, along with strong liquidity flows. Many are further along the recovery path than their developed peers, though, and therefore closer to a slowdown in momentum and tighter monetary conditions. Overheating asset values in China and the risk of excess tightening there in reaction are of particular concern.

Currency — Negative on majors, positive on economically strong currencies

Currencies of fiscally healthy economies exposed to the economic recovery, like the Canadian and Australian dollars, remain attractive. The euro is expected to remain threatened by the problems of weak member states like Greece. Sterling is threatened by the high risk that no party will win a governing majority in May elections. Japan is expected to promote a weak yen in its battle with deflation.

Consensus is growing that China will start revaluing its currency later this year – a move that would be widely welcomed as a signal that the global recovery is sustainable and as a step toward improved global and domestic Chinese structural balances.

Commodities — Positive

These asset classes should continue to benefit from rising manufacturing output and from demand from faster growing emerging economies.

REITs — Neutral to positive

The rise in global risk appetites should boost REIT valuations as the liquidity premium demanded by investors in risk-averse environments comes off. As a play on real assets, REITs should also benefit from the weakening of the US dollar.

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