Asset Allocation Views: Singles and Doubles

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of PIMCO

With market volatility on the rise, consider a broad set of relative value opportunities across global markets.

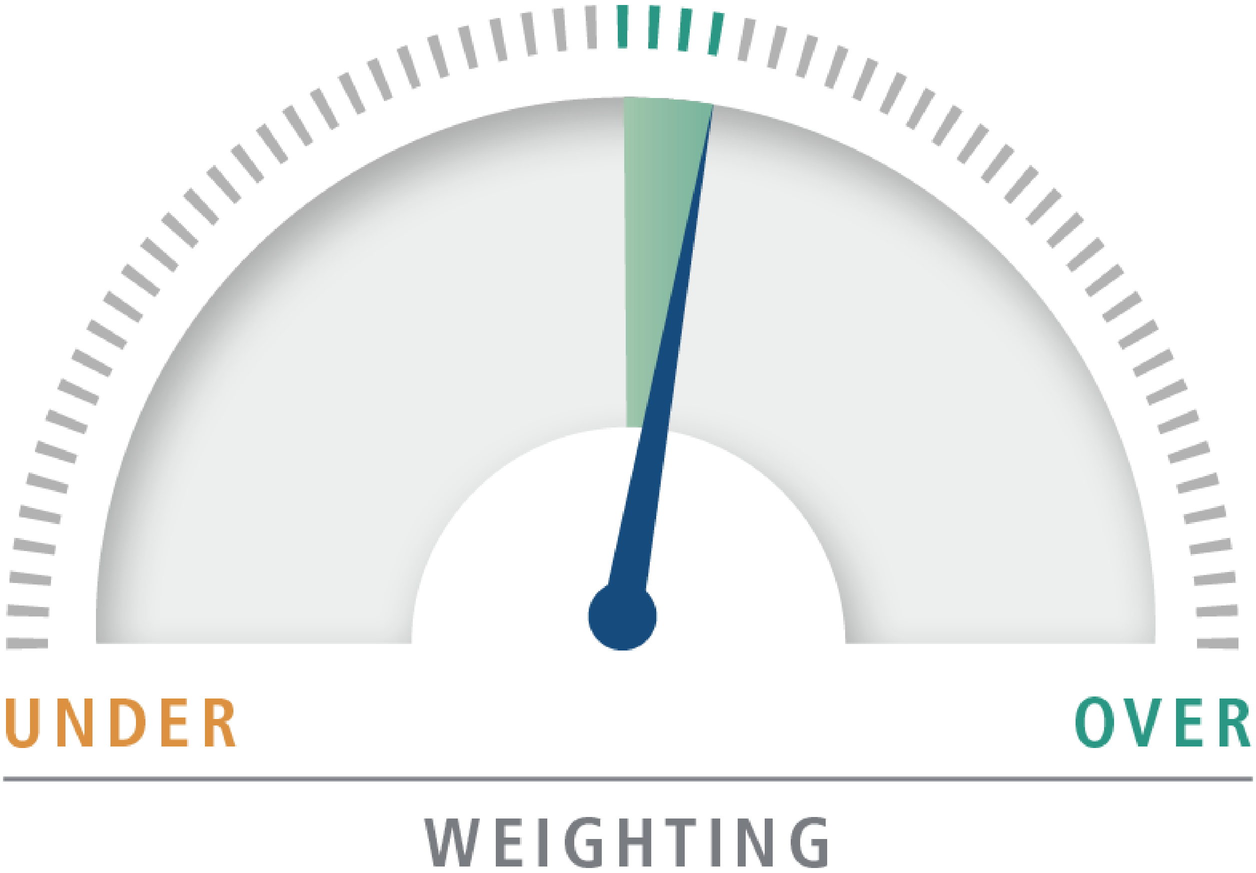
Markets entered 2018 with the wind at their back: double-digit equity returns, strong momentum, and expectations that the synchronized global growth and corporate earnings recovery we saw in 2017 should continue into 2018.

However, recent volatility suggests some storm clouds could be gathering. Central banks globally are moving away from emergency levels of easing, and large fiscal stimulus in the U.S. in the late stages of the business cycle could have unintended consequences.

Rich valuations combined with crowded positioning create an environment where investors should seek to grind out returns by pursuing multiple country- and sector-specific macro or micro relative value opportunities.

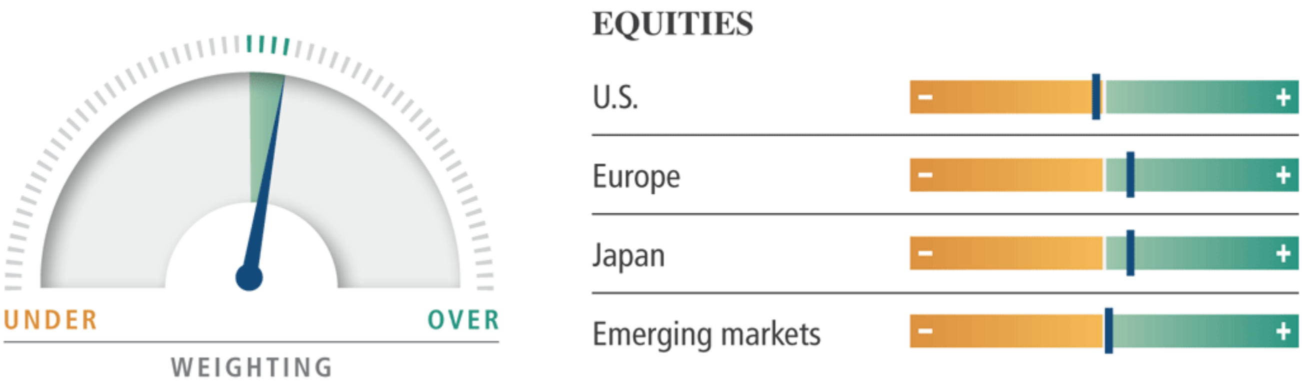
Here are our asset allocation themes for multi-asset portfolios in 2018. For further insights into global asset classes, please read our Asset Allocation Outlook, "Singles and Doubles."

Overall risk



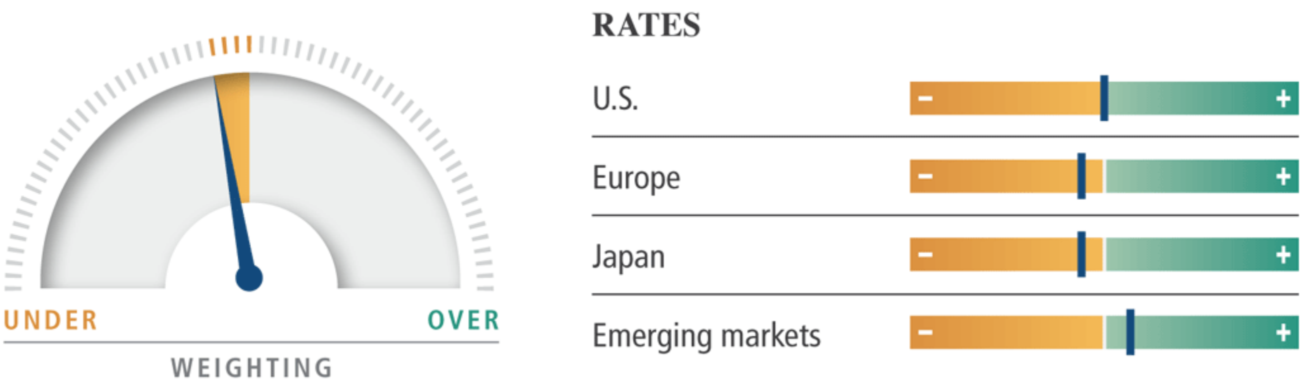
We are modestly risk-on in asset allocation portfolios, focusing on multiple relative value opportunities across sectors and regions. Synchronized, above-trend global economic growth and low but gently rising inflation are likely to characterize 2018, but this scenario is already reflected in most asset prices. Risks to the outlook include greater volatility, higher inflation and unstable stock-bond correlations – and policymakers may not have sufficient tools to effectively counter a downside turn.

Equities



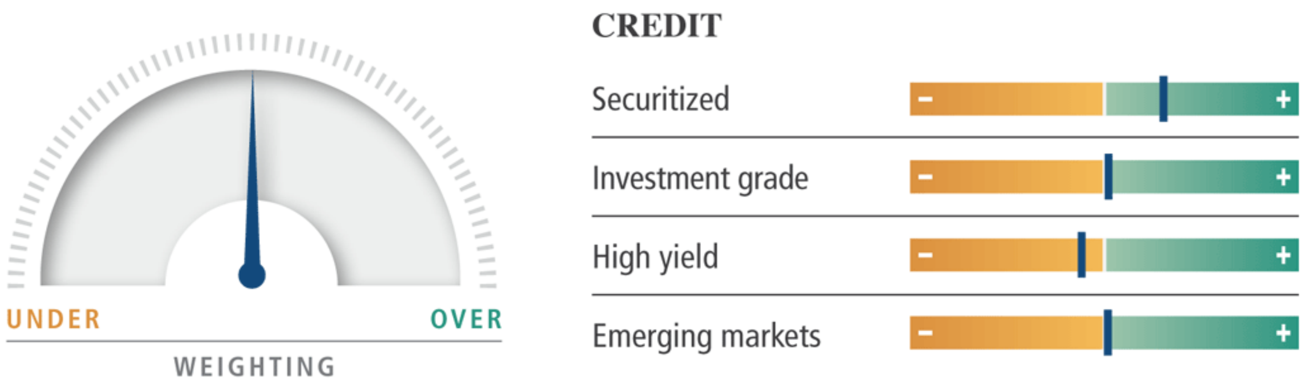
Given the recent cheapening, we are overall constructive on equities; we are overweighting non-U.S. markets relative to the U.S., where markets have already priced in a very optimistic scenario. That said, we do see an attractive opportunity in a combination of U.S. bank stocks and real estate investment trusts (REITs). We are moderately bullish on European equities, with growth in the region above trend and an accommodative European Central Bank (ECB). Attractive valuations and low corporate leverage are positives for Japan's equity market.

Rates



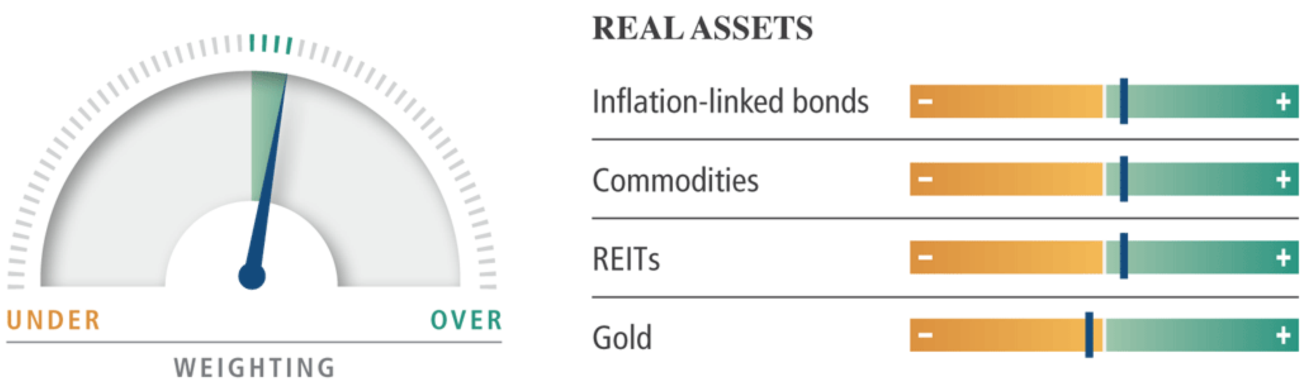
We remain defensive on interest rate exposure, though we believe an allocation to government bonds is important in the late stages of a business cycle. Among developed market sovereigns, we find U.S. Treasuries the most attractive due to their higher yields and convexity characteristics. U.K. gilts and Japanese government bonds appear rich, and we believe valuations of eurozone peripheral bonds are suspect without continued ECB support.

Credit



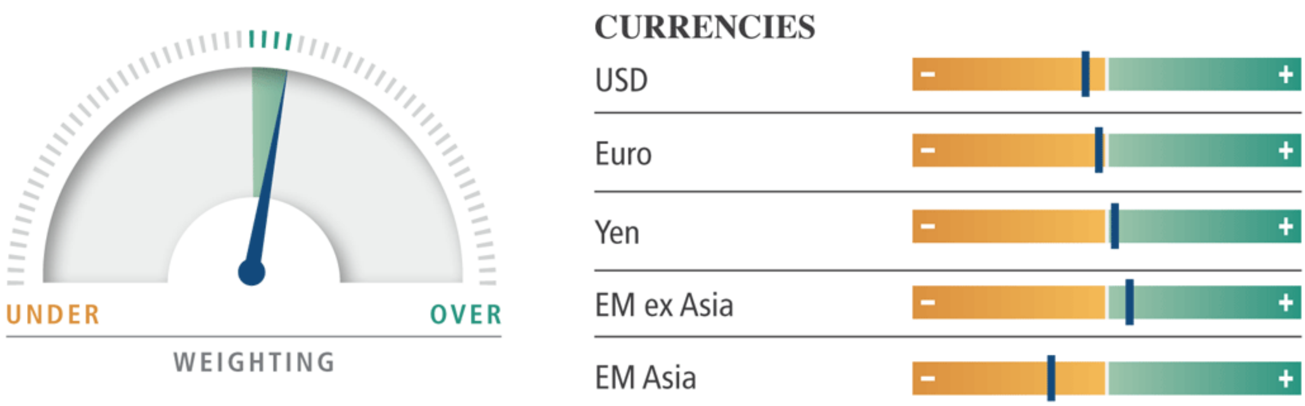
We are overall neutral on credit. At this stage of a maturing business cycle, investors should appreciate the limited spread-tightening potential of corporate bonds and consider reducing allocations to the more speculative sectors. We see attractive opportunities in non-agency mortgage-backed securities, which will likely continue to benefit from an ongoing recovery in the U.S. housing market and remain well-insulated from many global risks.

Real assets



We maintain an overweight to real assets, with a focus on U.S. Treasury Inflation-Protected Securities (TIPS). Inflation expectations have risen recently, yet we believe there is still value in TIPS as the market is underpricing U.S. inflation risk. We have a positive outlook on commodities, and we see real estate investment trust valuations as attractive given their recent underperformance.

Currencies



We are modestly underweight the U.S. dollar, and we continue to believe that EM currencies are a relatively attractive and liquid expression of our global macro outlook. Given weaker valuations and heightened political and trade-related risks, we focus on a diversified basket of EM currency positions. Emerging Asian economies have benefited inordinately from global trade, but are likely to weaken in the face of slowing Chinese growth.

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