NEUBERGER BERMAN

Asset Allocation Committee Outlook 2Q 2024

Breadth and Balance

The Asset Allocation Committee (“the AAC”) is positive on the economic outlook given resilient economic growth and the likely trend lower in inflation and interest rates. Nonetheless, our asset-class views remain largely neutral—which implies broad stock and bond market exposure—as many assets are fully priced and we anticipate a shift away from recent narrow market leadership. Our only two underweight views, on cash and hedged strategies, emphasize this theme of maintaining equity and fixed income positions to benefit from the current environment. Our overweight views on commodities and private markets reflect ongoing inflation and geopolitical risks and rich opportunities in illiquid assets, respectively.

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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 30 years of experience.

COMMITTEE MEMBERS

Joseph V. Amato
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Global Head of Alternatives

Market Views

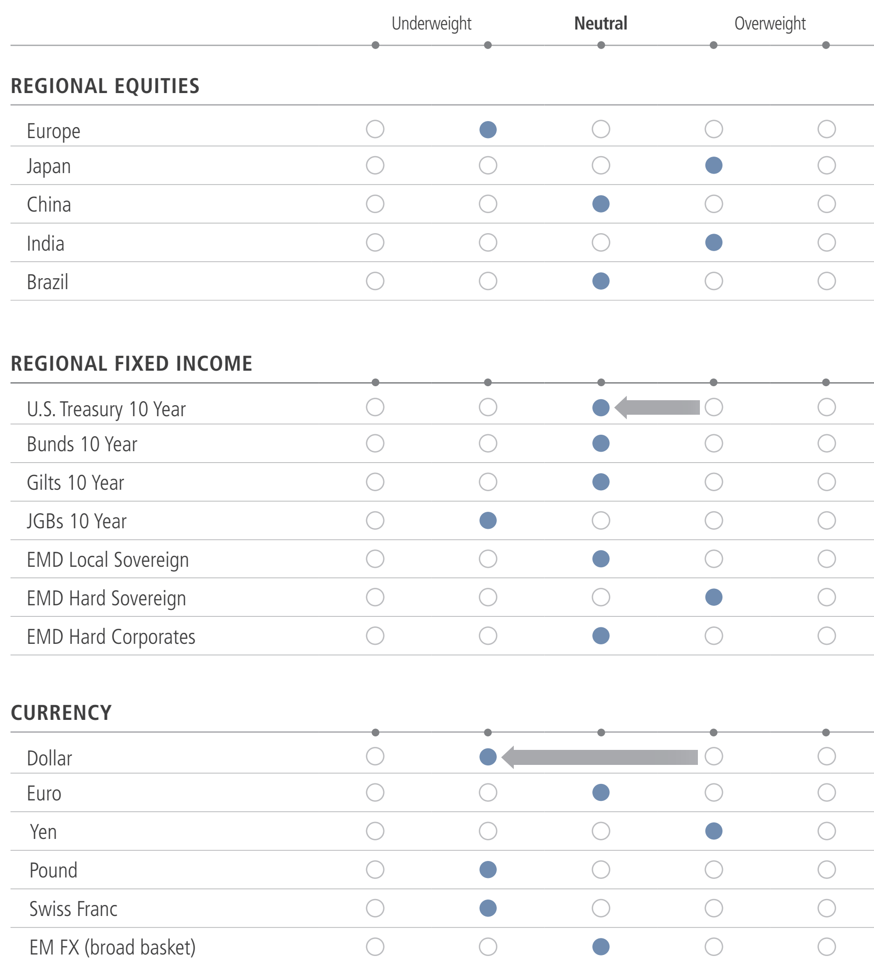
Based on 12-Month Outlook for Each Asset Class

	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 2Q 2024. Views shown reflect near-term tactical asset allocation views and are based on a hypothetical reference portfolio. Views on private market assets reflect the Asset Allocation Committee's views on the future return potential of new cash commitments, not the future return potential of existing investments. 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



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"The economic outlook may have improved, but large parts of the credit and equity markets are already priced for a soft landing."

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

Breadth and Balance

The Asset Allocation Committee ("the AAC") is more positive on the economic outlook than it has been for several quarters. Recession concerns have lifted, and while inflation could remain sticky, we think it is likely to continue to normalize. As investors shift focus from inflation and rates to the growth outlook, market dynamics such as stock-bond correlations have also begun to normalize. Our asset-class views retain their overall balance, which in part reflects this normalizing trend. The reluctance to take a more positive view on risky assets reflects ongoing geopolitical and U.S. election uncertainty, the full valuations in large parts of the market, and the concern that general economic resilience hides growing bifurcation between thriving "haves" and struggling "have-nots." The resulting balance extends into our view within asset classes. We favor broad equity exposure that encompasses more attractively valued, out-of-favor parts of the market, in anticipation of an end to the recent very narrow leadership in performance. In fixed income, we prioritize quality and income in the belly of the curve, between two and seven years. While we favor credit risk and locking in yield in anticipation of declining cash rates, we are cautious about the uncertainty around longer-term interest rates and debt sustainability. Our only two underweight views, on cash and hedged strategies, emphasize this theme of maintaining equity and fixed income positions to benefit from the current environment. Our overweight views on commodities and private markets reflect ongoing inflation and geopolitical risks and rich opportunities in illiquid assets, respectively.

The AAC Outlook at a Glance

- An upbeat view on the economy is paired with a neutral view on most asset classes.
- The economy and market dynamics are normalizing, but many assets are already fully priced: as a result, our asset-class views remain largely neutral—which implies broad stock and bond market exposure—as many assets are fully priced and we anticipate a shift away from the recent narrow leadership.
- Our two underweight views, on cash and hedged strategies, reflect this positive view on broad market exposure.

Up for Debate:

Will the Fed Cut Three Times This Year?

Where Do We See Stress in the System?

When the AAC met to review its outlook for the new quarter, the tone was as positive, as it has been since interest rates began to rise more than two years ago. The sentiment was not unanimous, but the majority of Committee members, those that have been expressing a balanced rather than pessimistic economic outlook over recent months, were notably more upbeat.

To a large extent, this was due to a lifting of recession concerns. We have now spent seven months at the peak of the fastest rate-hike cycle in history with little sign of stress in credit markets, job markets or the wider economy. In addition, the AAC noted a growing sense of normalization after four extraordinary years.

Most significantly, inflation has begun to normalize. We still think that core U.S. inflation, currently at 3.8%, could be stuck closer to 3.0% than 2.5% at the end of the year, but the disinflationary trend is more important to us than the level. Similarly, we are not entirely sure that the U.S. Federal Reserve (Fed) will make the three rate cuts that it and the market anticipate for this year, but the overall direction of travel now appears clear (see "Up for Debate: Will the Fed Cut Three Times This Year?").

These dynamics have allowed market participants to switch their focus away from inflation and rates and onto growth—which continues to be resilient in the face of higher rates. One notable result of this has been a recent reversal of the strong positive correlation between stocks and bonds that has characterized the past two years. There have been sharp adjustments to market expectations for Fed rate cuts in the first quarter of the year. That kind of adjustment would have weighed heavily on both stocks and bonds six, 12 or even 24 months ago, but now appears positive for stocks and negative only for bonds. We think that is because investors focusing on the growth outlook see not only recent economic resilience, but the prospect of persistently higher nominal growth than we have generally experienced since the Global Financial Crisis.

Our Headline Views: A Balanced Stance as Markets Price for a Soft Landing

Given this economic outlook, why have the AAC's headline views remained anchored to neutral?

First, we would regard a balanced overall view, reflecting an investor's typical long-term asset allocation to stocks, bonds and alternatives, as an appropriate position in response to a normal economic and market backdrop. Some Committee members noted that the AAC's over- and underweight views on the main asset-class groups have been gradually moderating over the past eight quarters, as we have moved through the current rate-hiking cycle and observed its impact on the broad economy.

Second, the economic outlook may have improved, but large parts of the credit and equity markets are already priced for a soft landing. Despite two years of rate hikes, liquidity remains abundant. The fiscal impulse remains strong in the U.S. and could be set to pick up in Europe. Companies and investors are still sitting on large amounts of cash that could be put to work over the coming months. Those are compelling reasons to remain exposed to risky assets, but they are also among the reasons why rates may yet stay higher for longer than market participants anticipate. When valuations are as full as they are today, they may be sensitive to any shift in market focus back onto inflation and rates. Much rides on a persistence of the new "Goldilocks" outlook.

Third, there is the opposite possibility: a negative development for growth, rather than inflation. Markets could be negatively affected by exogenous factors such as geopolitical and U.S. election uncertainty. We currently think more fundamental economic weakness is less likely, but the AAC does note that the apparent resilience of the broad economy masks diverging fortunes among the thriving "haves" and the struggling "have-nots" (see "Up for Debate: Where Do We See Stress in the System?").

The balance of all these risks and uncertainties has led the AAC to its current, overall neutral view.

> "Our views are notably balanced, and in fact our previous over- and underweight views have been gradually moderating for several quarters. This appears to reflect not only a lifting of recession concerns but also a general sense that we are moving back into the realm of 'normality' after four extraordinary years."
>
> **Joseph V. Amato,** Co-Chair, President and Chief Investment Officer—Equities

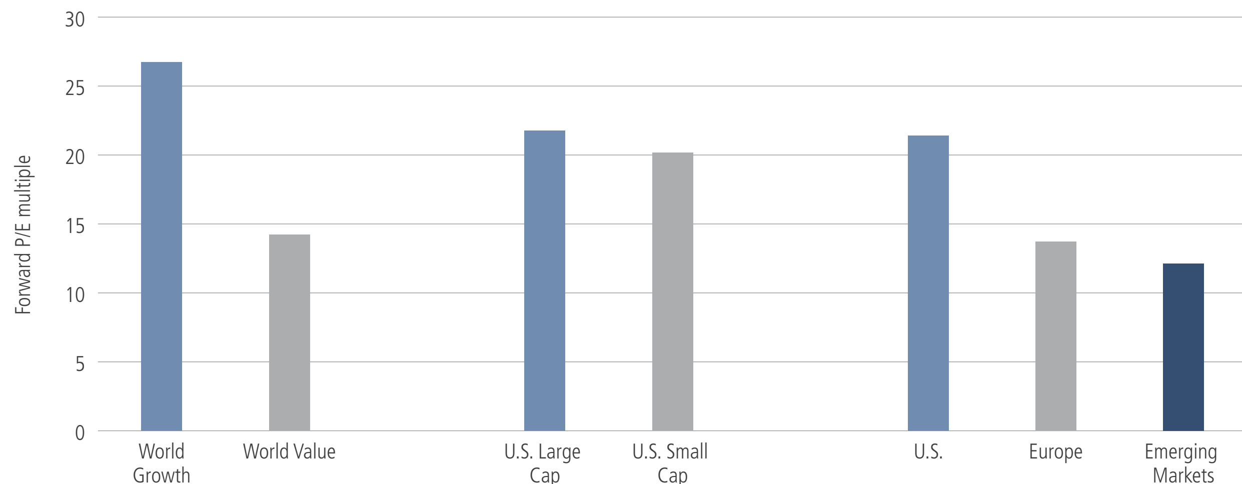
Equities: Anticipating Further Broadening of Market Performance

That balance continues into our views within asset classes.

Behind our neutral view on equities overall, we favor the less expensive, less momentum-driven parts of the market. That's partly due to the valuations themselves, and partly because we think the incipient broadening of market performance beyond groups like the "Magnificent Seven" and Europe's "GRANOLAS" is likely to continue in the new, normalizing environment.

This is why we still have a slightly more favorable view on (higher-quality) U.S. small- and mid-caps. The AAC is also shifting more decisively in favor of value stocks and becoming more positive on a broader range of non-U.S. equity markets.

POTENTIAL FOR FURTHER BROADENING OF EQUITY-MARKET PERFORMANCE: STYLE, SIZE, REGION



Source: MSCI. Indices used: MSCI World Growth Index, MSCI World Value Index, MSCI World Growth Index, MSCI USA Large Cap Index, MSCI USA Small Cap Index, MSCI USA Index, MSCI Europe Index, MSCI Emerging Markets Index. Data as of March 31, 2024. 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 or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

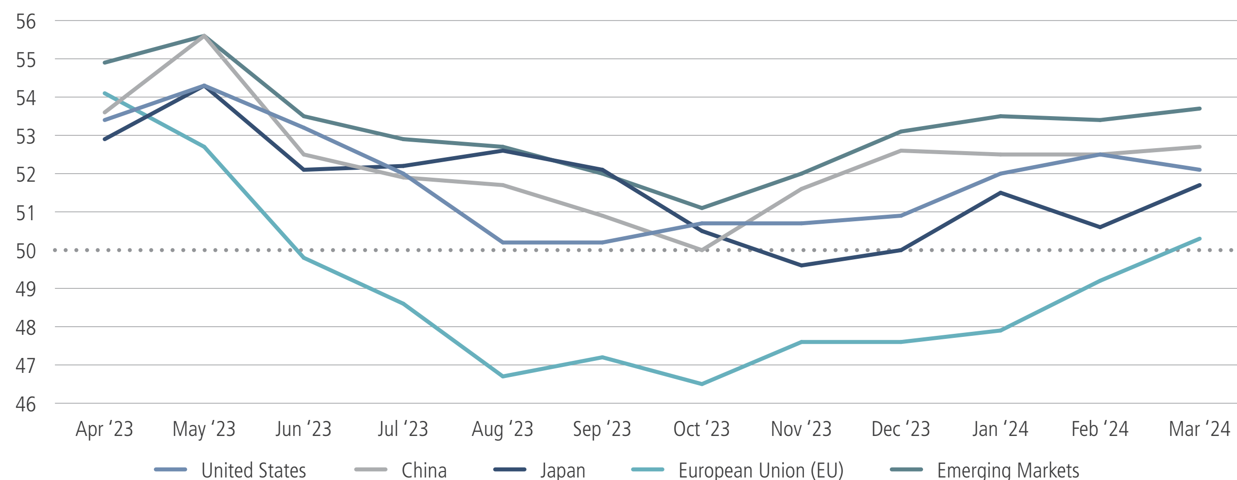
The regional view—outside of our more structural bullishness on Japan and India—remains tentative, dependent on a weakening of the U.S. dollar, a continuation of the incipient recovery in the manufacturing cycle and the absence of a meaningful negative growth or inflation surprise.

Japan equities have momentum, but it started from a low valuation base and we have favored this market for some time. During the first quarter of 2024 the Bank of Japan (BoJ), facing above-target inflation, raised rates for the first time in 17 years. It did little to interrupt the equity market's momentum, for several reasons. Inflows from foreign investors remain strong as they continue to rebalance a longstanding underweight, attracted by low valuations and a structural turn in favor of shareholder value on the part of Japan's corporate management. The change in monetary policy itself was widely anticipated and the mountain of reserves on which the BoJ pays interest is likely to cap policy rates at around 0.5%, in our view. Moreover, in its own way, it marks Japan as another normalization trade—the difference being that inflation and rates are normalizing upward here rather than downward.

The AAC has tended to be more cautious on Europe over recent quarters, seeing low valuations justified by weakness in its core economies. Some of that pessimism is lifting as we begin to see signs of recovery, powered by declining energy prices, suggestions of more fiscal support, and a rebound in manufacturing and other cyclical parts of the global economy. We await more confirmation of these trends and more evidence of investor rotation out of U.S. equity markets before upgrading our view.

SIGNS OF RECOVERING ECONOMIC ACTIVITY IN EUROPE

Composite Purchasing Managers' Indices



Source: FactSet, Markit. Data as of April 8, 2024. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

Fixed Income: Quality and Income in the Belly of the Curve

The Committee's fixed income views are similarly balanced.

Behind our neutral view on government bonds and overweight view on investment grade corporate bonds, for example, we favor the middle of the yield curve, between two and seven years. The positive growth outlook and what we regard as the likely decline in near-term interest rates are spurs to have exposure to credit and lock in yield. Significant uncertainty about the term premium makes us much more cautious about the long end of the curve, however; that uncertainty derives from our view on the potential stickiness of inflation, but also from concerns about public debt sustainability.

In credit, spreads continue to grind tighter and volatility continues to grind lower. Technical supply-and-demand dynamics remain the most important determinant of market movements, and there is a lot of cash on the sidelines ready to absorb new corporate issuance. It is difficult to envisage a move to an overweight view on high yield bonds without significant spread-widening, but concerns are not high enough to warrant a shift to the underweight view (See "Up for Debate: Where Do We See Stress in the System?").

Quality and income are the watchwords, anticipating higher volatility and potentially more attractive opportunities to add risk.

Alternatives: Favoring “Beta” Means a Downgrade for Hedged Strategies

In alternatives, the AAC’s views are little changed from last quarter.

We maintain an overweight view on commodities, and note strong performance in the first quarter, in recognition of ongoing inflation and geopolitical risks, as well as supply-and-demand imbalances in key areas such as energy and industrial metals.

We continue to see opportunity to supply capital and liquidity at attractive valuations in private equity secondaries, especially GP-led secondaries; in co-investments; and via capital solutions such as preferred and convertible stock or notes. Banks are returning to the corporate lending markets, and quality is increasingly becoming a differentiator as higher rates start to bite, but neither trend currently threatens our overweight view on private debt. Our very cautious view on core private real estate is offset by what we see as abundant opportunity in the value-add and opportunistic sectors, and particularly in real estate secondaries.

The downgrade to underweight in our view on hedged strategies has been coming for a few quarters. In an environment of low volatility, an absence of meaningful trends or broad distress, and technical supply-and-demand dynamics dominating fixed income markets, there have simply been fewer opportunities for many strategies. As the AAC’s view on the broad economy improved over the past quarter, leading us to the current position of favoring broad, well-balanced exposure to duration, credit and equity “beta,” the last resistance against an underweight view on low-correlation and market-neutral strategies has fallen away.

UP FOR DEBATE: WILL THE FED CUT THREE TIMES THIS YEAR?

The disinflation trend of the second half of 2023 has slowed somewhat during the first quarter of 2024. In response, investors have sharply adjusted their expectations for Fed rate cuts this year, from around six priced in four months ago to barely two today. As the AAC met, new data and commentary from both market participants and policymakers raised questions about whether the Fed would manage the three cuts in its own forecasts.

Some on the AAC are skeptical. They observe that financial conditions remain loose despite the rapid rate hikes of the past two years: corporations, consumers and investors generally hold a lot of cash, while the U.S. housing market, jobs market and wage growth show little sign of weakness. They argue that this is a central pillar of the AAC's positive view on the economy, but that it must also raise doubts about the prospect of three rate cuts this year.

At the very least, they suggest, three rate cuts this year implies no more in 2025. They point to the recent upward adjustment to the Fed's own longer-term rate forecast, and suggest there is growing risk of longer-dated U.S. bond yields getting stuck again in the 4.5 – 5.0% range.

The majority view on the Committee, which reflects the view of our Fixed Income team, differs not so much in terms of the inflation outlook as in terms of the Fed's reaction function.

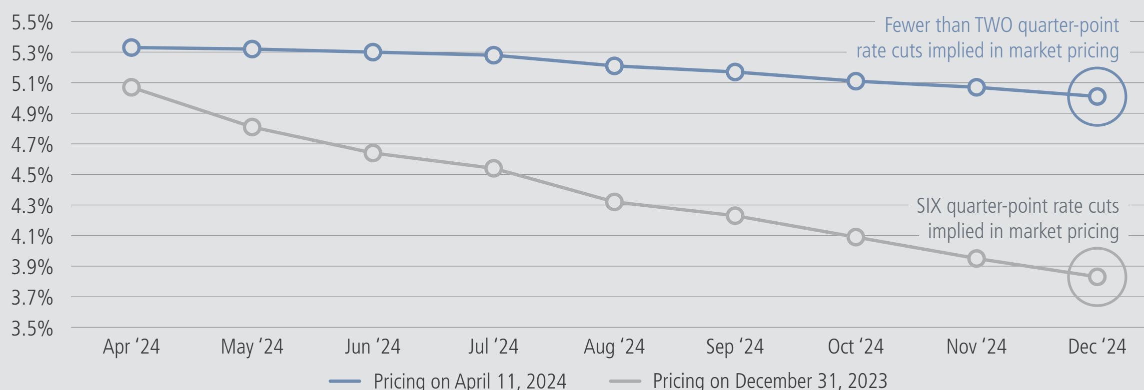
On the inflation pathway, the base case for the AAC is indeed somewhat higher than current market expectations: we think U.S. core inflation could still be 3% at the end of the year. However, the majority on the Committee think that the Fed would respond quickly to any sign of late-cycle weakness in the jobs markets (see "Up for Debate: Where Do We See Stress in the System?"), but remain steady in its commitment to rate cuts this year in the event of ongoing stickiness in the inflation data.

This view is informed partly by the Fed's own messaging about following but not overreacting to new inflation data: just as it did not react to lower-than-expected inflation prints at the end of 2023 by cutting early, it will not necessarily react to higher-than-expected prints in 2024 by holding rates at 5.5%. That follows from the pre-pandemic change to the Fed's policymaking framework, which means it now targets inflation at an average of 2% over the long run rather than a return to 2% as soon as possible. There may not be the substantial economic slowdown required to get inflation down to 2% in the next 12 months, but the flexibility of the new policy framework can allow the Fed to tolerate higher levels for longer, and even cut rates, as long as labor markets are not actually tightening and the trend remains disinflationary.

Overall, that leads us to assume an equilibrium policy rate of 3%, implying 100 – 200 basis points of easing in the coming cycle, while accepting some uncertainty around the timing of those cuts.

INVESTORS HAVE REVISED DOWN THEIR EXPECTATIONS FOR THIS YEAR'S RATE CUTS

Market-implied Fed Funds Rate, April 2024 to December 2024



Source: FactSet, Neuberger Berman. Data as of April 11, 2024. Future rates are implied from the pricing of 30-day Fed Funds futures contracts expiring at the end of each month. 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 or any historical results. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

UP FOR DEBATE: WHERE DO WE SEE STRESS IN THE SYSTEM?

The tale of 2023 was one of a recession deferred.

Deferred is not the same as cancelled. Even as economists' forecasts for global growth in 2023 steadily rose over the course of the year, their forecasts for 2024 and 2025 continued to decline, according to Bloomberg surveys. Coming into 2024 itself, however, cancellation has become the new consensus: growth is still expected to decline from 3% to around 2.7% this year, but the 2024 estimates have started to tick back up as "goldilocks" economic data increasingly points to the potential for a "soft landing" or "no landing."

Faced with that growing consensus, the AAC looked for stresses and risks in the system that could upset the current trajectory.

One concern is that general economic resilience hides growing bifurcation between the thriving "haves" and the struggling and potentially overleveraged "have-nots." We see this bifurcation at the consumer and the corporate level, and particularly in real estate.

The Federal Reserve Bank of New York's surveys of household debt, for example, suggest that while mortgage delinquencies remain low, credit card and auto loan delinquencies have been ticking up meaningfully. That divergence tells a story about the differing fortunes of lower- and middle-income consumers, which we also see in consumer sentiment surveys. The University of Michigan's survey disaggregates sentiment by income level, for example, and suggests that since the middle of 2023 it has continued to improve among the top and middle third while flatlining among the lower third.

While that might seem unexpected, given jobs-market headlines, underlying trends provide some explanation: while there is jobs growth in most sectors, most of the gains have come in defensive industries that are less sensitive to the broader economy, such as leisure, education and healthcare; cyclical sectors are creating notably fewer vacancies. More than one Committee member wondered if the Fed's steadfastness on its three cuts for 2024, despite sticky inflation data, was due to policymakers perceiving some underlying or incipient weakness in the labor market.

A similar bifurcation exists between larger, often cash-rich companies and smaller businesses that face a challenging refinancing environment. The NFIB Small Business Optimism Index has dipped notably since the beginning of the year; moreover, respondents have switched the single most important problem they are facing from labor quality to inflation, reinforcing concerns about jobs-market resilience and persistently high rates. Our Fixed Income team noted some recent liability-management exercises among some more leveraged companies, taking advantage of the loose covenants on their debt to the detriment of some lenders—not enough to change our view on credit to an underweight, but enough to reinforce our preference for high-quality issuers.

The picture is clearer in real estate, in our view. As we highlighted in last quarter's *Outlook*, there is growing bifurcation between strong, proven operators with resilient balance sheets in sectors that have strong fundamentals, and those with vulnerable balance sheets stranded in sectors on the wrong side of structural trends. We think this is already creating abundant opportunity in the value-add and opportunistic sectors, and particularly in real estate secondaries, but we also believe the sheer size of the challenges facing the real estate sector broadly is likely to make this a multiyear story.

None of these weak points are enough to derail the broader economy, in our view. However, alongside exogenous factors such as geopolitical and U.S. election uncertainty, they are where the AAC is looking for potential downside risks in the months ahead.

EQUITIES

U.S. EQUITIES Current view: Neutral | Move from last quarter ◀▶

We anticipate further broadening of equity-market performance, which leads us to continue to favor small and medium-sized companies, and a balance between styles.

NON-U.S. DEVELOPED MARKET EQUITIES Current view: Neutral | Move from last quarter ◀▶

We believe momentum in Japanese equities can continue, and that an incipient rebound in manufacturing and other cyclical parts of the global economy could begin to favor Europe over the coming months.

EMERGING MARKETS EQUITIES Current view: Neutral | Move from last quarter ◀▶

A cautious outlook on China is balanced by a more favorable view on other emerging markets, including India, where strong growth should remain a tailwind.

FIXED INCOME

INVESTMENT GRADE FIXED INCOME Current view: Overweight | Move from last quarter ◀▶

We continue to favor the short and intermediate parts of the yield curve in anticipation of declining cash rates, but remain cautious on longer-dated bonds on debt sustainability concerns.

Corporate spreads are now quite tight, and we see the most attractive opportunities in securitized credit.

NON-U.S. DEVELOPED MARKET BONDS Current view: Neutral | Move from last quarter ◀▶

Yields are relatively attractive, especially in the two- to seven-year part of the curve, but high economic uncertainty in Europe, caution on Japanese government bonds, and on longer-dated bonds in general, inform against moving to a more positive view.

HIGH YIELD CORPORATES Current view: Neutral | Move from last quarter ◀▶

Our outlook for credit stresses remains mild and idiosyncratic rather than systemic, and we see a case for shorter-duration, high-quality exposure.

That said, we think investors buying yield have kept spreads tighter, in many cases, than fundamentals warrant.

EMERGING MARKETS DEBT Current view: Neutral | Move from last quarter ◀▶

Valuations remain relatively high although the potential for U.S. dollar weakness later in the year may enhance our outlook.

REAL AND ALTERNATIVE ASSETS

COMMODITIES Current view: Overweight | Move from last quarter ◀▶

While not as cheap as they were three months ago, commodities remain a useful hedge against inflation spikes, upside growth surprises and geopolitical shocks in 2024.

HEDGED STRATEGIES Current view: Underweight | Move from last quarter ▼

We currently prefer broad market exposure to hedged strategies, and also see fewer clear signals in the trending and macro environment.

PRIVATE EQUITY Current view: Overweight | Move from last quarter ◀▶

Private equity remains attractive as policy rates peak and exit activity looks set to pick up. Secondaries and co-investments are attractive as both Limited Partners and General Partners seek liquidity options to complete deals and increase distributions.

PRIVATE DEBT Current view: Overweight | Move from last quarter ◀▶

While signs of a re-opening in the syndicated loan market point to a potential rise in competition for deals over the coming quarters, yields remain attractive and we see ample deal flow.

REAL ESTATE Current view: Neutral | Move from last quarter ◀▶

Higher interest rates and uncertainty about the office sector is creating value opportunities for liquidity providers in public REITs and private real estate secondaries, and there may be value to come in primary private markets.

More structurally, we believe post-pandemic growth dynamics will continue to support key sectors such as data centers, warehouses, industrial and multifamily residential.

CURRENCIES

USD Current view: Underweight | Move from last quarter ▼

The dollar has already shown some weakness over the past two quarters, but the Fed's relatively dovish response to sticky inflation data so far this year could continue to weigh on the currency.

EUR Current view: Neutral | Move from last quarter ◀▶

Eurozone economic activity remains weak, but the euro remains undervalued based on interest rate differentials and expected growth rates, particularly against other European currencies.

JPY Current view: Overweight | Move from last quarter ◀▶

The JPY still appears very undervalued, especially after the Bank of Japan's first rate hike in 17 years and the abandonment of yield curve control. The central bank appears unwilling to act aggressively, but as global yields decline the downward trend could reverse, potentially sharply.

GBP Current view: Underweight | Move from last quarter ◀▶

Despite being undervalued and supported by recent economic data coming in better than expected, the GBP can still be weighed down by concerns over the U.K.'s growth and productivity; fiscal space is limited and likely to be used to "buy votes" in an election year.

CHF Current view: Underweight | Move from last quarter ◀▶

Switzerland has a positive current account balance and declining global yields could relieve some carry-trade pressure, but the CHF is still very overvalued; as inflation pressures subside, the Swiss National Bank is likely to withdraw support for the currency, allowing some of this overvaluation to correct.

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Index Definitions

The **MSCI World Value Index** tracks the performance of large- and mid-cap stocks across 23 developed markets countries that exhibit overall value style characteristics.

The **MSCI World Growth Index** tracks the performance of large- and mid-cap stocks across 23 developed markets countries that exhibit overall growth style characteristics.

The **MSCI Europe Index** captures large and mid-cap representation across 15 Developed Markets countries in Europe. With 427 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across the European Developed Markets equity universe.

The **MSCI Emerging Markets Index** is a market-value weighted index designed to represent the performance of large- and mid-cap securities in 26 emerging markets.

The **MSCI USA Index** is designed to measure the performance of the large and mid-cap segments of the U.S. market. With 609 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the U.S.

The **MSCI USA Small Cap Index** is designed to measure the performance of the small cap segment of the U.S. equity market. With 1,768 constituents, the index represents approximately 14% of the free float-adjusted market capitalization in the U.S.

The MSCI USA Large Cap Index is designed to measure the performance of the large cap segments of the U.S. market. With 277 constituents, the index covers approximately 70% of the free float-adjusted market capitalization in the U.S.

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