PORTFOLIO INSIGHTS

Global Equity Views

Themes and implications from the Global Equity Investors Quarterly

2Q 2018

IN BRIEF

- World stock markets have paused and volatility has returned, precipitated by concerns that trade tensions, and/or a monetary policy mistake, could bring this economic cycle to an end.
- We recognize the risks, yet see enough support from rising profits and sensible valuations to stay invested in stocks—and note that volatility is still moderate by long-term standards.
- Emerging market equities remain a favorite and Europe is more appealing after recent underperformance.
- Financial stocks worldwide offer plenty of opportunity and the high-flying technology sector, while clearly less attractive now, is not yet a threat to investors.

TAKING STOCK

At first glance, the current environment remains rather favorable for equity investors. Profitability is strong and continues to rise around the world, interest rates are still very low in most countries and valuations don't yet look excessive, for the most part. But after an exceptionally positive 2017 and a rip-roaring start to 2018, investors have become more nervous, fearing that a breakdown in international trade relations or a monetary policy mistake could bring this economic cycle to an end. Volatility has returned to markets, with investors more inclined to punish perceived disappointments rather than celebrate successes.

We recognize these concerns and believe that after a long cycle, which began in the depths of the global financial crisis almost a decade ago, we have probably seen the best returns from equity markets. But we don't see any reason to expect an imminent end to the strong global profit growth that began two years ago—we think there are still opportunities for further gains. We recommend keeping equity investments at long-term average levels, at least, although aggressively positive allocations no longer seem sensible.

In the following pages of our Global Equity Views, we present our thoughts on the investment outlook, discuss market trends and spotlight both opportunities and risks. **EXHIBITS 1** and **2** present snapshots of our outlook, as discussed and debated at our Investors Quarterly in April 2018.

AUTHOR

Paul Quinsee
Managing Director and Global Head of Equities

TRENDS

While the upswing in global corporate profits that began in mid-2016 continues, market participants understand this trend well, making positive surprises much harder to generate. Current expectations now reflect the boost to U.S. earnings from lower corporate tax rates, although the expected buybacks, dividend increases and additional spending as a consequence of the tax windfall have yet to be fully revealed. Profits across a range of emerging market economies are moving steadily higher, even though positive surprises are less frequent now. European profitability has been mildly disappointing, both as a consequence of the euro's strength and Europe's relative lack of high-growth companies vs. the U.S. and, perhaps, Asia. Nonetheless corporate profits remain very supportive for stocks in Europe and elsewhere around the world.

Growth stocks continue to dominate, as they have for most of the past decade, led by strong performers including the much-publicized Internet giants, together with more cyclical semi-conductor companies. At the other end of the performance tables energy stocks lagged significantly until recent weeks, and "bond proxies" have struggled ever since U.S. interest rates started to move higher.

OPPORTUNITIES

Regions

We continue to believe emerging markets will offer the best returns in the next couple of years. So far, the upswing in emerging markets profits is less mature compared to the U.S.; market valuations are reasonable on all the measures we analyze; and the interesting, longer-term secular case for many of these markets is not really priced in. To be fair, Turkey and Russia are currently experiencing economic weakness and some stocks (for example, many Indian consumer companies) are pricey. On balance, we are inclined to add to our emerging market holdings during this period of trade uncertainty, and during this period of USD appreciation, which usually poses a short-term challenge to developing markets. European equities have disappointed slightly, in local currency terms, with the major indexes little changed during the past year of euro appreciation. Corporate concerns—in particular, weak capital allocation and a lack of profit growth at many big companies—have also contributed to Europe's underperformance. But overall, we see European equities as an opportunity. Economic growth is healthier than recent data points suggest and, perhaps more importantly, companies are reasonably priced. They are also showing signs they are hearing shareholders' concerns, amid a wave of pressure from U.S.-based shareholder activists.

Sectors

Financial stocks continue to merit a high weighting in many of our equity strategies. The sector, which languished after the global financial crisis, has partially returned to favor in the last couple of years, but valuations are still sensible. Profitability is improving at a healthy clip, helped by better economic conditions and the recent rise in U.S. interest rates. And with tougher capital standards largely met, profits are flowing back to shareholders in stock repurchases and higher dividends. Investors must, however, remember the risks in the financial sector, which is still highly levered (though less so than going into the 2008 financial crisis) and often opaque. Decades of experience tell us we are rarely successful when we compromise on balance sheet quality, and the more complex the business, the greater the risks. Leadership always matters, but in this industry it matters a great deal.

Views from our Global Equity Investors Quarterly (April 2018), Part I

EXHIBIT 1A: WHAT DO YOU EXPECT FROM WORLD EQUITY MARKETS IN THE NEXT 18–24 MONTHS?

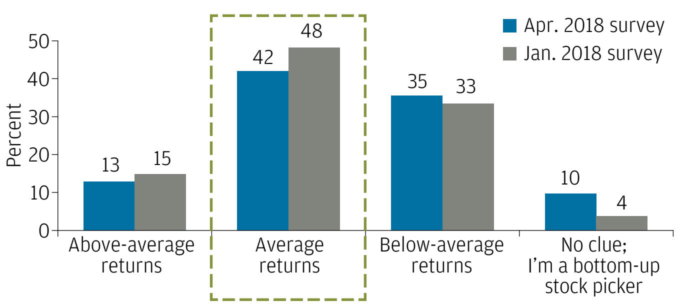
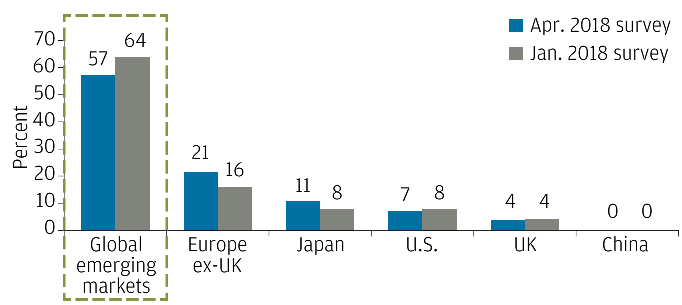


EXHIBIT 1B: THE REGION I THINK WILL DELIVER THE BEST RETURNS OVER THE NEXT 18–24 MONTHS IS:



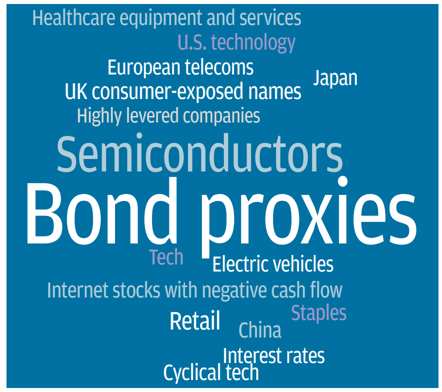
A subset of survey results are shown for Global Equity Investors Quarterly participants, taken in April 2018. These responses are taken from a quarterly survey, representing 31 CIOs and senior portfolio managers across global equities.

J.P. Morgan Asset Management estimates shown as of April 2018, for the J.P. Morgan Asset Management developed market equity coverage universe. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections and other forward statements, actual events, results or performance may differ materially from those reflected or contemplated.

Views from our Global Equity Investors Quarterly (April 2018), Part II

BEST OPPORTUNITY GLOBALLY?

WORST OPPORTUNITY GLOBALLY?



BIGGEST RISK GLOBALLY?

A subset of survey results are shown for Global Equity Investors Quarterly participants taken in April 2018. These responses are taken from a quarterly survey, representing 31 CIOs and senior portfolio managers across Global Equities.

Meanwhile, as the U.S. economic cycle approaches a record age, we have been wondering whether the bond proxies have become interesting again. After all, these stocks (typically defined as consumer staples, telecoms, utilities and REITs) are considered defensive and less vulnerable to recession, and have under-performed meaningfully the past 18 months as interest rates have risen. They are certainly now more reasonably priced compared to their post-crisis history. But in many cases, underlying profit trends are weak, particularly for many consumer staples companies, where an unpleasant combination of rising competition and costs is squeezing profitability. We also question whether real estate stocks fit the bill as more defensive investments, given the sector's high leverage and traditionally high beta in weak equity markets. Many of our investors are looking to add, but selectivity remains key.

RISKS

At a macro level, the prospect of a sharper than expected transition to higher interest rates remains the biggest threat to the world's equity markets. Yes, stocks are still attractively priced vs. bonds in all regions; even in the U.S., where rates have risen meaningfully this year, the earnings yield of the S&P 500 is still about one percentage point above the yield of the average corporate bond—which itself is fairly generous by past standards. But the gap has narrowed, suggesting less margin for error than was previously the case. And higher rates would eventually threaten the expansion itself, while U.S. companies are set to enter the next downturn with high levels of debt by most measures (the financial sector is a notable exception). With the gradual winding down of quantitative easing and the need to finance enormous deficit spending in the U.S., we are mindful of the risks of higher rates and cautious about companies with high debt levels, especially when (as is often the case) secular trends are pressing on the underlying profitability.

Within the markets, one concern is whether technology stock prices are sustainable or have reached a level of excessive exuberance. The gains have been spectacular and relatively new companies now occupy the top positions in market capitalization, in both the U.S. and Asia. If Internet stocks have performed very well, so have their businesses; valuations, at least for the major companies, don't yet look excessive. This view rests on the assumption that profits are sustainable—and regulators may yet have their say. Semiconductor companies have been enjoying a spectacular cycle, yet even as current trends remain very strong, the sustainability of their profits appears more questionable. So we are keeping a watchful eye on emerging excesses but are not ready to call an end to the trend of technology sector outperformance just yet.

CONCLUSION

After last year's extraordinary combination of strong returns and low volatility, equity markets were bound to get more difficult. That has indeed come to pass. The proximate causes, trade wars and tighter monetary policy, may have cast doubts on the economic cycle's longevity. Still, we think there is enough profit growth ahead to stay fully invested in equities, even while we recognize that the balance of risk and reward is now less compelling. Emerging markets and Europe are worth attention and the financial sector is still relatively attractive.

BUILD STRONGER EQUITY PORTFOLIOS WITH J.P. MORGAN

Our equity expertise is founded on deep resources across regions and sectors, and a commitment to nurture the brightest talent. Delivering consistent results is at the heart of everything we do.

Outcome-oriented active management:

- Benefit from the ***local market expertise*** and deep resources of our globally integrated team of experienced equity investment professionals.
- Gain a broader view on equity markets with our ***timely macro and market views***, and be guided by our proprietary portfolio insights and equity analytic tools.
- Invest across a broad range of ***actively managed*** equity strategies, covering multiple investment styles and geographies.
- Partner with one of the world's leading equity managers and benefit from our ***long history of innovation*** and success.

NEXT STEPS

For more information, contact your J.P. Morgan representative.

PI-GEV_2Q18 | 0903c02a81d3120a

J.P.Morgan
Asset Management