Private Bank

Market Perspectives

February 2020

BARCLAYS

Foreword

The start to the year has shown the impact of exogenous shocks as a risk to financial markets as opposed to a true weakening in fundamentals, something we highlighted in our Outlook 2020.

Tensions between the US and Iran rose significantly and unsettled investors in early January. In the alternatives article, we consider oil's vulnerability to supply-side shocks and how gold can be used successfully as a diversifier in a multi-asset portfolio.

The debate on globalisation continues to be centre stage, with a signed "phase one" US-China trade deal. Arguably the main event of 2020 shaping the future of globalisation will be the race to the White House, which gets under way in February for Democrats, with the influential Iowa caucus and New Hampshire primary.

The record-setting rally on Wall Street continued in January, with all three indices at fresh highs as investors tuned out geopolitical "noise" and focused on improving global growth, accommodative central banks and consensus-beating fourth-quarter US earnings.

However, the impact of the coronavirus news on markets shows that investors are not far away from doses of reality, with elevated equity valuations and modest growth expectations tempering the potential for upside surprises.

After a strong 2019 for bonds, investors are looking for pockets of value. We look for opportunities for generating returns against a backdrop of negative yielding debt and the potential for sharp climbs in bond yields.

Finally, January's news cycle was filled with both the World Economic Forum in Davos and wildfires in Australia. The link between them is climate change. Following our climate change insights in the Outlook 2020, we explore the physical risks that investors will need to consider to protect their portfolios from such extreme weather events.

Jean-Damien Marie
and Andre Portelli,
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Globalisation to the fore

The reshaping of globalisation will continue to be a key driver of financial markets, along with the search for yield, increase in fiscal commitments and strategic diversification.

In our Outlook 2020, we highlighted four investment themes which we thought would be important over the next few months when considering an investment: globalisation; tactical hedging and strategic diversification; enhancing total returns with yields; and from monetary to fiscal policy. In January we have already had several events showing that those four themes are likely to be important topics in 2020.

Globalisation is already a key topic

The debate around globalisation is omniscient. From the geopolitical tension in the Middle East between the US and Iran, to the signing of "phase one" of the US-China trade agreement, and notwithstanding the divergent views regarding climate change expressed at the World Economic Forum in Davos, questions regarding globalisation and cooperation have already been front and centre in 2020.

"The debate around globalisation is omniscient"

We expect that this will continue to be the case, with the coming US presidential elections probably the most significant geopolitical event this year.

Nervous financial markets call for diversification

While US equities are posting all-time highs, global markets have been nervous whenever unexpected events happened. Performances have still reflected a feeling of general apprehensiveness.

It is not the typical cyclical sectors that have outperformed so far in 2020 but rather the more defensive and qualitative companies. Equally, as we expected, gold continues to help diversify a portfolio and performed well in January. After breaching 1,500 US dollars an ounce (USD/oz) at the end of 2019, it almost reached 1,600 USD/oz at the peak of the geopolitical tension in the Middle East early in January.

With uncertainty still high and stretched valuations, we continue to like tactical hedging and strategic diversification such as the one gold provides in a multi-asset portfolio context.

Value in yields

Although markets have started the year on a positive note, we would expect price returns to be relatively muted in 2020 and much lower than the stellar performance achieved across asset classes in 2019. In that context, we think it is important to find opportunities to add yield to a portfolio. With interest rates close to record lows across the world, yield strategies can include selective emerging market sovereign debt, "alternative" strategies focusing on carry or finding sustainable yields through companies with strong cash flow in equities. As with all of our 2020 investment themes, we think that the best approach is to focus on active management rather than passive investment.

Fiscal stimulus to grow in importance

Liquidity continues to be an important factor for financial markets. But we would expect fiscal stimulus to become more prominent as a theme in 2020. As previously mentioned in our Outlook 2020, it will be about targeted stimulus rather than large overall economic stimulus.

March's budget will provide a first indication as to what to expect in that respect. Fiscal spending is likely to be an important feature of the US presidential election campaign. It is too early to find targeted investment opportunities, but we believe the shift to fiscal stimulus will become more relevant this year.

"We believe the shift to the fiscal stimulus theme will become more relevant this year"

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February's crystal ball for Democrat candidacy race?

The US election race gets underway in February and is set to create heightened uncertainty for financial markets and ramifications for the shape of globalisation.

Very few investors would disagree that the number one political event this year is the US elections. In a turbulent first term for President Donald Trump, which includes trade wars, regular criticism of US Federal Reserve Chair Jerome Powell and impeachment proceedings, the president's go-to indicator, a strong stock market, still remains intact.

The path to election day on 3 November is likely to be eventful and uncertain, triggering renewed financial market volatility.

Path to the White House

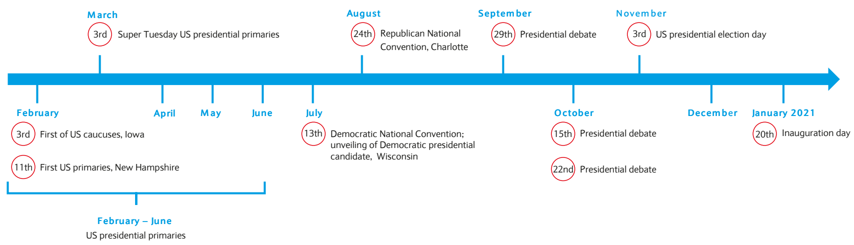
The path begins in February with a five-month process for Democratic candidates, where caucuses and primaries in each state will lead to an eventual challenger to the president being announced at the Democrat national convention on 13 July in Wisconsin.

The first caucus, in Iowa on 3 February, and the first primary, in New Hampshire on 11 February, are crucial for leading hopefuls and underdogs alike (in the case of the Democrat party). They are an opportunity to sustain momentum, or in the case of the underdogs to create momentum of their own and take it away from the favourites before the Super Tuesday primaries on 3 March.

History suggests that Iowa and New Hampshire give an early indication as to which candidate is likely to win the nomination. In the 2004 and 2008 elections, the winner in the Iowa caucus won the nomination and received roughly a 30 percentage point increase in the likelihood of being nominated directly after the caucus.

Furthermore, the caucus is a good guide as to those candidates that will not be successful. Since 1972, no candidate who has finished fourth of worse has gone on to win the nomination. In the last six elections, no candidate has won nomination without taking either the Iowa caucus or the New Hampshire primary, illustrating the importance of generating early momentum.

US 2020 elections timeline



Sources: FEC, Datastream, Barclays Private Bank. January 2020

Global impact

President Trump won swing states such as Florida and North Carolina in 2016 and overcame the Democrat's "blue wall" by taking Wisconsin, Pennsylvania and Michigan. However, the economic and political landscape has changed and whether Trump can win re-election with record low approval ratings is the big question of this election.

In our Outlook 2020, we highlighted how globalisation has taken a step back and has been slowed down by trade conflicts, heightened tensions in the Middle East and a general rise in populism. The next step is either towards further separation (President Trump re-elected) or a return towards a more cohesive, but still fairly fragmented, global order (a Democrat wins the presidency).

One consequence of the election race that is probable is uncertainty and volatility weighing on the economy and markets. With uncertainty regarding the future US international policy, we prefer to focus for the time being on assets exposed to the US consumer. We will review the impact and prospect for the US elections regularly throughout the year.

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Equities: too far, too fast?

Equities have started the year with a bang, with some markets setting fresh highs. With valuations stretched and another rollercoaster year on the cards for investors, we believe staying disciplined through it all is appropriate.

Equity markets continued their relentless march higher thanks to unabated multiple expansion in January. The market seems to have run ahead of itself, though. While there is a risk of further overshoot driven by acronyms such as a FOMO (Fear Of Missing Out) or TINA (There Is No Alternative), we question how long such enthusiasm for equities can last.

Reasons to stay optimistic

The bull argument is simple: the world will remain awash with liquidity while the economic backdrop is improving. Indeed, the bar for central banks changing course and tightening monetary policy still appears elevated given subdued inflationary pressures. In addition, although uninspiring, earnings growth is set to resume in 2020. And finally, the main uncertainty that has affected markets over the past year or so, namely the trade tensions between the US and China, has been reduced.

This goldilocks scenario is further supported by expectations that the US president will do everything he can to boost equity markets ahead of the November election.

Is 20 the new norm?

Although fundamentals have yet to show signs of improvement, the above arguments were sufficient to propel stock markets to decade-old record highs. Investors now appear convinced that paying 19 times forward earnings in the US, something not seen outside the early 2000s dot-com bubble, is justified.

Furthermore, given the low interest rate environment, a valuation multiple of 20 is not out of reach according to some, at least until the recent developments related to the coronavirus.

We remain sceptical of this, although our bull case (multiples to expand by another 1.5 points vs. the end of the third-quarter 2019) may be more likely to materialise.

Beware of euphoria

While accommodative monetary policy certainly provides strong support to risk assets, valuations can't ignore the reality of the economic cycle forever. While the risk of recession, or at least significant slowdown, seems to have receded, we continue to believe that growth is unlikely to re-accelerate meaningfully. The recent outbreak of coronavirus in China certainly clouds the short-term outlook.

> "Valuations can't ignore the reality of the economic cycle forever"

We also struggle to reconcile the market's current narrative that a rebound in growth will be accompanied by further easing from central banks. Surely, if activity stabilises, the incentives for hiking interest rates will be higher.

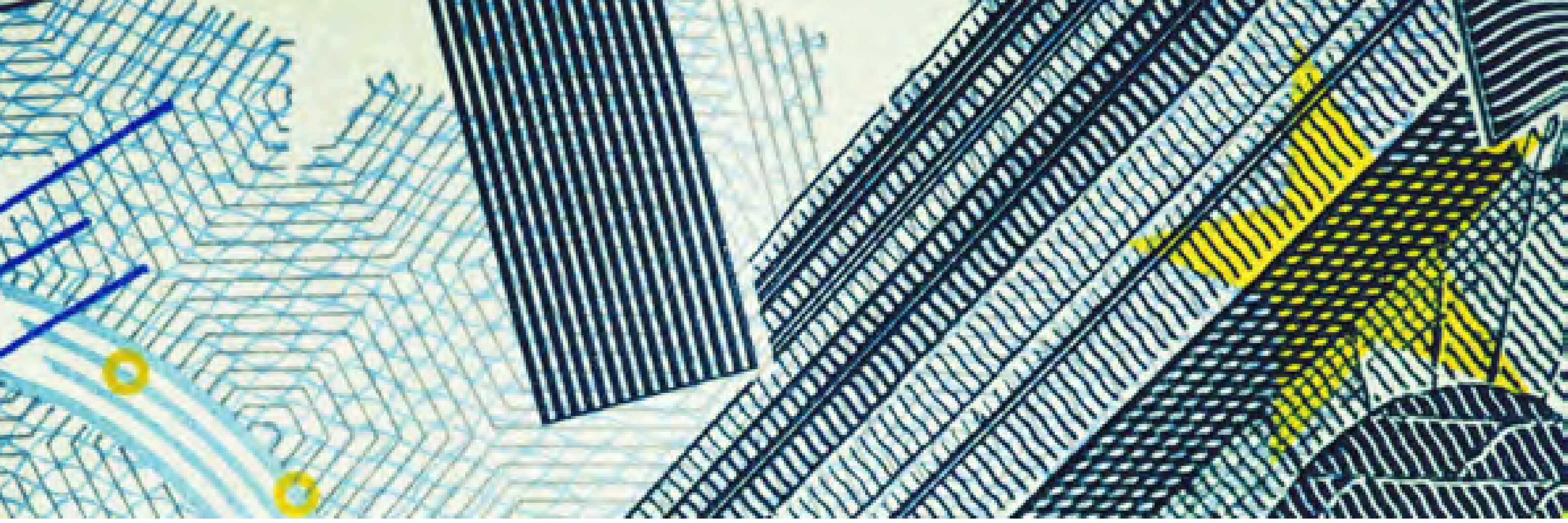
Staying disciplined

In this tug of war between bulls and bears, we believe that the most appropriate strategy is to remain disciplined. Chasing cyclicality and beta may sound appealing in a melt-up scenario but the prevalent optimism would leave us exposed to any negative surprises – and there will be some along the way. Similarly, taking profits and "waiting for a pullback" remains a loss-making proposition over the medium term. Instead, we see merits in staying invested while adjusting the risk/reward of portfolios.

Diversification, diversification, diversification

We want to maintain a healthy balance between defensives (such as healthcare) and cyclicals (consumer discretionary and some industrials) but with a clear focus on "quality". Although this strategy may lag in a strong bull market, it should still provide attractive returns over time.

In addition, we believe that tactical hedging makes sense when appropriate and cheap enough. Finally, we see benefits in favouring active versus passive management given the dangers of chasing "beta" in the current environment.



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A closer look at risks in the bond market

Bond markets performed well in 2019. With the chance of higher volatility, higher default risk and possibility of rating downgrades, does value still exist in the asset class?

In hindsight 2019 was a "blue sky" scenario for bonds: the economy was not too hot and not too cold. Bond assets across various segments delivered double-digit returns. After last year's rally, is there any value left in bond investments?

We believe that there is still value although admittedly returns are likely to be limited and selection even more so important. With yields and spreads alike at low levels, we take a closer look at the potential risks facing investors.

Risks for rates to sky rocket

The US 10-year Treasury yield rose to almost 2% early in January from 1.45% in September. Over the last ten years it seems rates have consolidated, with a large upward move within 12 months after the yield reached 1.5% (see chart). Will we see the same pattern again this time after the yield reached these lows in August 2019?

While the reason for bond market corrections always seem to be different (for instance, the US Federal Reserve's (Fed) "taper tantrum" in 2013 or the US fiscal stimulus-induced correction in 2016) one common feature can be observed. The moves have been fed by extreme positioning around a strong consensus view.

Although a correction should not be ruled out in coming months, there does not seem enough reason to justify either a long-term trend change or a significant re-pricing in bonds. The US-China "phase one" trade deal has been absorbed by the market while US stimulus, even in the wake of the US elections, might be contained this time.

A pick-up in inflation, or inflation expectation, may be another reason for rates to trend higher. Under the current period of slowing growth, as indicated by lower manufacturing indicators for example, it is hard to believe that there is enough room for a significant change in recent trends.

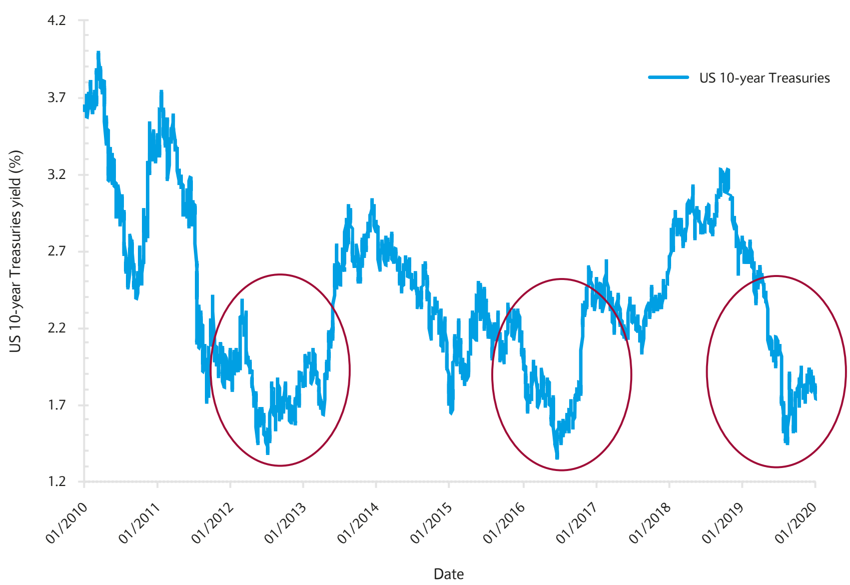
Given that market implied inflation expectations seen in breakeven rates are comparatively low we see some upside surprise potential. Inflation surprise could be triggered by higher wage growth due to ultra-low unemployment rates or from a Fed running a looser strategy and accepting higher inflation. Inflation linked bonds therefore seem reasonably priced to hedge against that surprise potential.

Risk of 0 or negative yields

Will we see even further depressed yields in 2020 or a spill over to other markets, like the US or UK, that are "not supposed to offer negative yields"?

Is the rate market due another correction, as seen in 2013 and 2016?

The chart shows that US 10-year Treasury yields rose significantly from lows in 2013 and 2016. Yields reached similar low levels last year.



In Europe there is an increasing debate about the effectiveness of negative yields and more concerns about the harm it creates (for instance, on bank profitability or diminishing savings). However, it seems unlikely that the European Central Bank (ECB) will change its policy for some time given the prospects of depressed inflation. European yields are likely to stay lower for longer.

Spillover effects

Negative rates have already had a spillover effect on US yields. The large interest rate differential between the two markets, which currently stands at approximately 1.7% for 5-year swap rates, drives flows into the US market which prevents yields drifting too much apart. By contrast with the ECB, the US built up a buffer and thus has scope to reduce rates. So even in a recessionary scenario negative yields in the US seem highly unlikely.

UK rates, on the other hand, seem more at risk of slipping into zero or negative territory. While Bank of England strategy is against a negative yield policy, the policy rate is only 0.75% away from zero and interest rate markets at times tend to push rates down below the policy rate, along the curve. Although we do not forecast significantly lower yields, the risk of it happening is higher than in the US and should not entirely be ruled out.

As long as rates are trading close to zero or below, medium duration higher quality bonds will enjoy higher demand in order to mitigate zero or negative rates globally.

Risk of defaults and downgrades

Recently the International Monetary Fund listed "rising corporate debt burdens" as a key vulnerability in the global financial system. According to the latest World Economic Reform report across G20 economies, public debt is expected to have reached 90% of gross domestic product (GDP) in 2019 – the highest level on record – while non-financial corporate debt reached 156% of GDP in China and almost 50% in the US, also the highest level ever recorded. For bond holders specifically, high leverage translates into increased default or downgrade risk.

The global default rates in the speculative grade or high yield market are still comparatively low at 2.8%, but have been on the rise recently. Tepid growth and low funding costs may support high yield issuers. But with record debt levels, the margins to serve debt payments are lower. While Moody's in their base case scenario see the global default rate moving towards 3.3%, lower than expected growth or event risk have the potential to push default rates even higher.

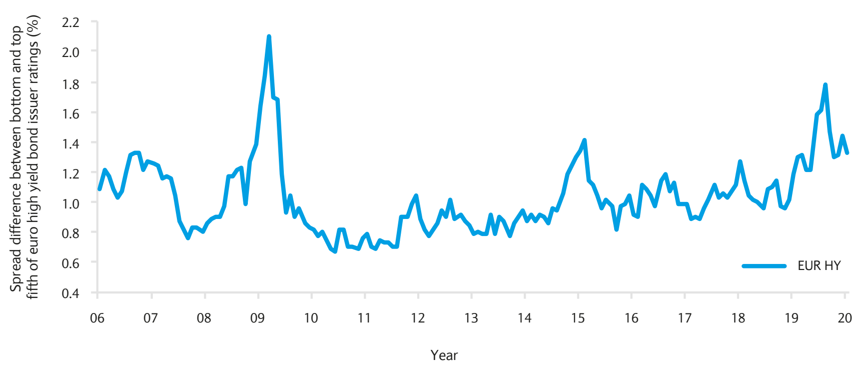
> "The main risk for investment grade bonds is rating downgrades"

The main risk for investment grade bonds is rating downgrades. With approximately 50% of listed bonds now rated BBB, a large wave of downgrades could cause spreads to widen significantly. According to Moody's, however, 83% of investment grade bonds have maintained their rating 12 months into a recession in the past 30 years. It is encouraging to see that very large BBB issuers have put debt reduction at the forefront by selling assets or cutting dividends in order to maintain their rating lately.

Downgrades as well as default rates are likely to rise in 2020. While we favour investment grade over high yield, we would be selective in both markets. Selection is also important given the increasing dispersion in spreads within different issuers. In recent years the average spread of lower quality issuers vs. higher quality issuers in each HY market has increased significantly (see chart).

Increasing spread diversion in the euro high yield bond market

The chart shows the difference in the spread between the lowest-rated fifth and the highest-rated fifth of issuers in the euro high yield bond market, since 2006



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Navigating the volatile world of geopolitics deterioration

Gold and oil prices have already spiked this year as sparks flew in the Middle East. With more geopolitical trouble likely this year, do allocations to gold and oil make sense?

The world has had to live with hostilities in the Middle East for many years and is likely to do so for many years to come. This inevitably leads to short-term gyrations in financial markets and in particular the prices of gold and oil. Investors should have a strategy in place to understand the drivers of both commodities and protect their portfolios from the resulting instability.

Middle Eastern sparks

In our Outlook 2020 we suggested that this year would be characterised by uncertainty. One area we identified that uncertainty would emanate from is geopolitical tensions and specifically the Middle East. This prediction came to fruition much quicker than expected.

Global risk sentiment was at elevated levels in early January following America's decision to kill Iran's top military advisor, Qasem Soleimani, and Iran attacked two US military facilities in retaliation. As news of the military action filtered through to investors, it sent a tremor through financial markets. Equities traded sharply lower, Brent surged above $70 a barrel and gold pierced the $1,600 an ounce level for the first time since 2013.

The skirmish between the US and Iran quickly developed into the biggest foreign policy test for Donald Trump's administration. Ultimately, as the US sustained no loss of life in the attacks and Iran stated it was not seeking war, President Trump summarised that Iran had stood down thereby precipitating a de-escalation in tensions.

The lower risk environment helped stock markets to recover and oil and gold to ease back from elevated levels. However, unprepared investors could have easily fallen into the news cycle snare, encouraging them to drastically alter their positions.

Crude's climb is likely to be contained

Disruption in the Middle East was one of the factors that propelled the price of Brent up 37% in 2019. Supply concerns surged following Iran's seizure of tankers in the key shipping lane of the straits of Hormuz, the attack on Saudi Arabia's oil production facility, as well as US sanctions on the exporting of Iranian oil. Energy markets have also reacted to lower production from the distressed producers of Libya and Venezuela along with OPEC+'s, that is the 14 members of the Organisation of Petroleum Exporting Countries plus allied producers, decision at the end of last year to increase and extend production cuts.

> "Disruption in the Middle East was one of the factors that propelled the price of Brent up 37% in 2019"

While a rise in the price of crude might seem inevitable over the next few months, there are a range of downward price pressures. Analysts have been reducing their demand growth expectations for oil due to moderate global growth forecasts. Energy markets have also had to calculate the impact of rising US production levels. The US recently became the world's largest oil producer, overtaking Saudi Arabia. The US Energy Information Administration forecasts that the US will produce a record 13.3m barrels per day (mbpd) in 2020.

Supply and demand dynamics for oil in 2020 point to a market in reasonable balance. Current economic conditions suggest an increase in demand of 1.3mbpd in 2020. Rising production from Canada, Brazil and Norway along with the US suggests non-OPEC supply growth of 1.7mbpd. This points to an average price of $62 a barrel for Brent, and $57 for West Texas Intermediate, in 2020. Periods of unrest may result in extreme fluctuations in energy prices, but these are likely to be short lived.

Gold: the ultimate safe-haven asset

Deteriorating international relations are often the catalyst for investors to seek shelter in safe-heaven assets. For many investors gold continues to be the "insurance" of choice. This was in evidence last year as investors reacted to a broad range of risks by adding 10.3m ounces last year into gold exchange traded funds (ETFs), with total gold held by ETFs rising by 15%. These investment flows helped the gold price to climb by 18% in 2019.

The price of gold is supported by lower interest rates and central bank purchases. Lower interest rates help compensate for holding a zero interest-bearing asset. Central banks, have increasingly looked to gold to help diversify their holdings away from the US dollar.

Rising investment demand and central bank diversification has helped to offset lacklustre demand growth for jewellery, as well as rising production and recycling levels. In order to justify a gold price dramatically above $1,600 in 2020, there would need to be a significant worsening in the political and economic outlook; possibly coupled with concerns of debasement and a weaker dollar as was the case in 2011.

> "In order to justify a gold price significantly above $1,600 in 2020, there would need to be a significant worsening in the political and economic outlook"

Gold's attraction as a safe-haven asset remains debatable. Bullion is devoid of inherent characteristics which uniquely qualifies it as the ultimate store of value. However, if enough people believe it, it starts to generate its own reality.

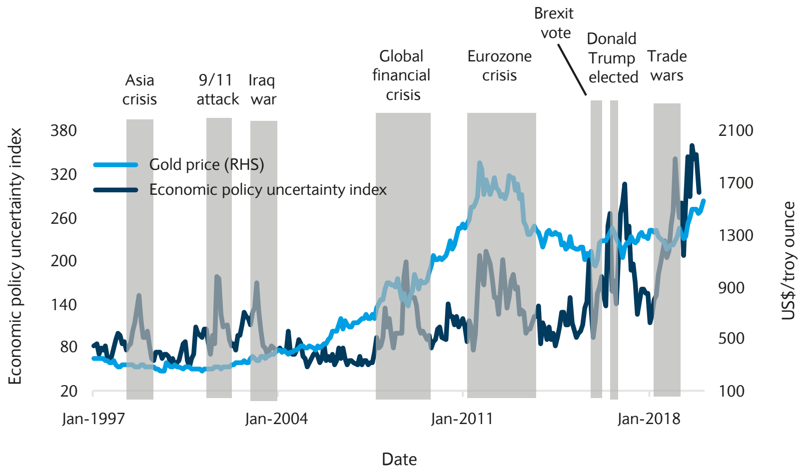
Over long periods of time gold has proved to be a hedge against inflation. However, for most investors gold should primarily be used as a diversification tool. Gold should help to preserve wealth during times of turbulence, rather than be considered a driver of performance over prolonged periods.

For longer term investors, the best way to traverse periods of financial market dislocation is through a globally balanced, diversified portfolio. Investors should remain cognisant that most flare-ups tend to be more limited in scope than the original headlines might suggest.

Staying invested, harnessing gold's insurance properties and looking for opportunities of mispriced crude are the key to navigating the volatile world of geopolitics.

Gold can insure against increased uncertainty

The gold price tends to rise when the economic policy uncertainty index climbs



Source: Datastream, Barclays Private Bank

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Could your investments go up in smoke?

As the frequency of extreme weather events rises and global temperatures climb, it's time to appreciate the physical risks of climate change for your investments.

With the start of the year, wildfires in Australia have led to countless animal deaths, people fleeing from blazes into the ocean and skies darkened by smoke. It highlights how climate change is exacerbating the extent and severity of natural catastrophes.

The effects of the Australian fires have not yet been fully costed or assessed. But, in the three months to 7 January, insurers received more than six times the annual average number of claims received over the prior five years. By comparison, Californian utility group Pacific Gas and Electric, which was an A- rated credit in 2017, was the first company to declare bankruptcy, in 2019, pointing to climate change's effects in respect of the state's Camp Fire wildfires seen in 2018.

Physical effects from climate change have severe implications for communities, companies and investors. In our Outlook 2020, we highlighted the value of starting to position portfolios for the implications of climate change. To help that process, we now look at the physical risks that climate change produces.

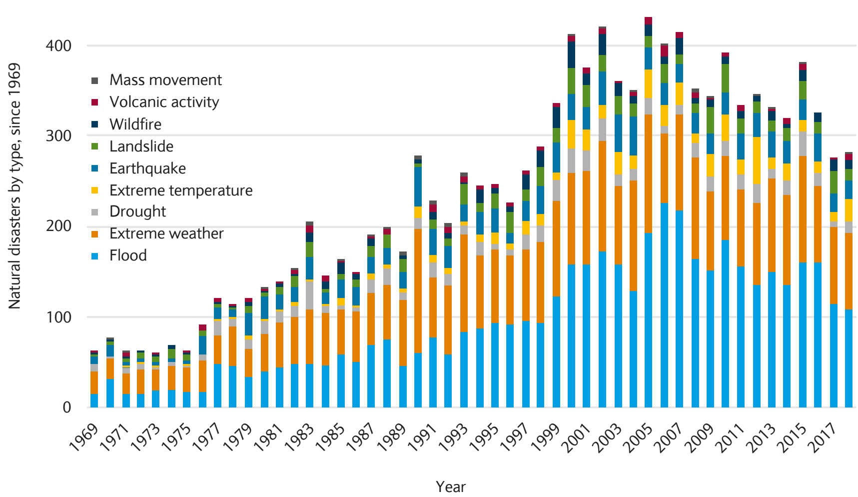
More frequent and severe weather

Weather has always been variable. Extreme weather events have occurred in the past. Yet, these events are becoming more frequent and intense with climate change (see chart).

Physical effects of climate change are driven by the increase in average temperatures along with change in global and local weather patterns. Their impact can be through acute weather events (such as stronger hurricanes due to warmer oceans) or "chronic" longer term changes to trend (for instance, rising sea levels due to a combination of thermal expansion and the melting of land ice). In combination, they can be particularly devastating.

Natural disasters by type, since 1969

The chart shows the annual number of natural disasters, weather and non-weather related, by type since 1969



Source: EM-DAT (2017), OFDA/CRED International Disaster Database, Our World in Data

When listed, the range of weather events sounds apocalyptic – storms, heatwaves, droughts, rising sea levels, flooding or ocean acidification. However, the sad reality is that we are experiencing such events today, and with increasing regularity.

Implications of physical risks for companies

With increases in both acute and chronic physical effects, their potential materiality and cost increases too. The Task Force on Climate Related Financial Disclosures highlights potential financial impacts of physical risks to include:

- Reduced revenue from decreased production capacity (for instance, transport difficulties, supply chain interruptions)
- Reduced revenue and higher costs from negative impacts on the workforce (such as health, safety, absenteeism)
- Write-offs and early retirement of existing assets (for instance, damage to property and assets in "high-risk" locations)

- Increased operating costs (say, inadequate water supply for hydroelectric plants or to cool nuclear and fossil fuel plants)
- Increased capital costs
- Reduced revenues from lower sales/output
- Increased premiums and potential reduced availability of insurance on assets in “high-risk” locations.

Assessing whether the above financial impacts will occur depends on the likelihood of primary physical risks and then any secondary implications. Primary physical risks cause direct damage to assets (such as land, buildings, stock and infrastructure) due to the physical effects of climate-related events.

Secondary physical risks arise as climate change generates more indirect risks that affect supply chains and extended value chains. For example, availability of key resources, like water, sourcing and quality of raw materials, or rising costs of assets and commodities. In the extreme, extended physical damage in a country or region can produce conflict and mass migration due to food and resource scarcity.

All sectors of the economy face both types of risks from the physical effects of climate change. The chance, and consequences, of any particular risk and impact will vary by sector, company, and location. The table below summarises some of the physical climate impacts and their effects on a company’s value chain.

Checking portfolios for climate-related risk

With climate change posing greater material financial risks, investors now need to consider how to incorporate the physical risks into their portfolios. Assessing physical risks can be approached starting by a sector or geography and/or evaluating a specific company. Vulnerability to these risks goes beyond physical assets and across the value chain, as well as supply chain, customers, and markets. More importantly, resilience depends on company or governmental management, planning and governance.

Climate change is accelerating and becoming more visible. Weather-related natural catastrophes are causing hundreds of billions of dollars-worth of losses worldwide. Longer term shifts in weather patterns, while not as obvious today, have deeper implications for companies and communities. Whether continued climate degradation can be sufficiently addressed, society faces greater risks. Investors should prepare accordingly.

Sector	Illustrative climate effects (short and long-term)	Potential impact on value chain
Agriculture, Food & Beverage	• Increasing average temperatures • Heatwaves and wildfires • Flood and landslide • Rising sea level • Water scarcity and drought	• Decreased crop yield and potential crop failures • Increased irrigation demand and costs • Loss of productive land (e.g. due to increased soil salinity) • Altered growing conditions and seasons (e.g., resulting in price volatility) • Disruptions to distribution network, farmers and labour force
Apparel	• Rising average temperatures • More frequent extreme weather events • Changing rainfall patterns and increased rainfall intensity – water scarcity & drought • Changes in pest and disease distribution and prevalence	• Fluctuating availability, quality, and cost • Disruptions for operations and workers at manufacturing facilities • Disruptions in supply chain and distribution network, including transport, warehouses, and stores • Shifting consumer preferences (e.g., less reliable seasonal cycles and temperatures)
Tourism	• Increased weather extremes and variability • Rising sea level and coastal erosion • Droughts, heatwave and wildfires • Increased exposure to diseases	• Damage to infrastructure and facilities • Decreased attractiveness of tourism destinations • Disruptions of transportation (e.g. flights, cruises)
Insurance	• Virtually all physical effects, including hurricanes and storms, wildfires, floods, droughts, sea level rise, thawing permafrost, and increased exposure to diseases	• Increased claims, losses, and liabilities • Difficulty in pricing physical perils (e.g. new products to address physical climate risks) • Reduced availability and affordability of some types of insurance • Reduced value of investment portfolio
Electric Power	• Increased intensity and duration of extreme weather events, such as heat waves, storms, and floods • Rising sea level and higher storm surges • Water scarcity	• Reduced output – disruptions in supply chain and distribution network • Damage to infrastructure and facilities • Changing seasonal power demand and increased peak demand • Increased electricity losses in transmission and distribution systems due to heat load
Oil & Gas and Mining	• Increased intensity and duration of extreme weather events • Rising sea level, higher storm surges, and increased coastal erosion • Land and sea ice melting and permafrost thawing • Changes in pest and disease distribution and prevalence	• Damage to infrastructure and facilities • Constrained access and production of resources/reserves • Constrained exploration, processing, refining, and site rehabilitation • Higher decommissioning costs • Disruption of transport and distribution systems • Rising risks to employee health and safety

Sources: Adapted from Physical Risks from Climate Change, Oxfam America, Calvert Investments, Ceres, 2012

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Multi-asset portfolio allocation

Barclays Private Bank discusses asset allocation views within the context of a multi-asset class portfolio. Our views elsewhere in the publication are absolute and within the context of each asset class.

Cash and short duration bonds: high conviction

- Our preference for higher quality, liquid opportunities translates into our positioning in short duration bonds

- Although real interest rates remain negative in most jurisdictions, we maintain a high conviction in the asset class from a risk management perspective.

Fixed income: neutral

We see moderate risk-return opportunities in fixed income given the recent spread tightening and late-cycle dynamics. Although sovereign rates are less attractive in the context of a low yield backdrop, they offer true protection in very weak economic environments. For this reason, we maintain a small overweight in developed government bonds.

In credit, we prefer the higher quality segment, given their relative safety and better returns. We remain cautious on the riskier parts of the corporate debt market as they don't entirely compensate investors for the level of risk taken at a time when credit events may be on the rise. Emerging market bonds offer opportunities to enhance fixed income returns given relatively attractive spread levels, but active selection is key.

Developed government bonds: high conviction

- Developed government bonds worldwide have been losing their appeal as rates edge down amid softening economic growth, lower inflation expectations and dovish monetary policies. However, as economic data continues to deteriorate, we see the asset class as a diversifier and increase our holding to a small overweight

- Although US dollar real rates remain at historically low levels, they are still too attractive to ignore relative to the other developed bond markets. UK and European bond markets have failed to synchronise with US rates due to their own geopolitical challenges. Furthermore, depressed yields make it difficult to find both markets attractive, apart from in respect of managing overall portfolio risk. It was for this reason that we made a small addition to the asset class in January.

Investment grade bonds: neutral

- Supportive financial conditions and moderate growth should be broadly positive for investment grade bonds and limit the risk of a sudden spike in default risk. Moreover, investment grade-rated companies still look healthy given their high interest coverage and generally low funding costs

- Nevertheless, we remain neutral on the asset class as we expect spread volatility to increase in a late-cycle environment

- Although spreads have tightened significantly since the beginning of this year, we believe further tightening is limited and investment grade bonds will continue to earn some carry and so outperform low yielding government bonds, specifically in Europe.

High yield bonds: low conviction

- While default rates are at historically low levels and corporate fundamentals remain robust, we maintain low conviction to the asset class as margin pressure typically increases late in the economic cycle

- Even following the recent consolidation in riskier assets, high yield bonds look expensive. Spreads are tight by historical standards, which we do not view as attractive in the context of the credit and liquidity risk taken and the returns available from other asset classes. For this reason, we have reduced our exposure in January.

Emerging market bonds: neutral

- The Fed's dovish stance should continue to provide some relief to the largely dollar-denominated emerging market (EM) debt. Higher energy prices stemming from geopolitical tensions in the Middle East should also be supportive

- Although unresolved trade disputes provide a headwind to emerging market bonds, credit quality hasn't deteriorated and the economic momentum backdrop remains reasonably positive

- Spreads have tightened since the beginning of the year as investor flows reverted back into EM bonds amid improving sentiment. That said, spreads remain comparatively wide versus high yield bonds and offer a better risk-return profile, as well as opportunities for carry trades. We favour US dollar emerging market hard-currency bonds due to their relatively attractive valuations and therefore, have recently increased our holding in the asset class in January.

Equities: positive

Positioning in high quality, growth companies through active management is our preference given our view that in late cycle, alpha (actively selecting superior businesses) outperforms beta (passively following the market). While we remain positive, we have modestly cut our positive view to reflect the growing risks the global economy is facing. Regionally, we see more compelling opportunities in developed market equities where we maintain high conviction, while we remain neutral on emerging market equities from a risk budgeting perspective. However, not all emerging markets are created equally and so warrant selectivity, with Asia appearing to provide more stable (albeit lower) growth than Latin America.

Developed market equities: high conviction

- Earnings growth is still expansionary, albeit slowing, with growth forecast to be low-to-mid single digits over the year. Healthy fundamentals continue to underpin the investment case for this asset class, while valuations are not excessively stretched compared to history

- Increasingly accommodative central banks and fairly constructive macro data out of developed economies should continue to support the asset class, even though downside risks from trade tensions and geopolitical issues should limit the upside potential

- We favour active management and selective stock picking of companies with strong balance sheets, although we are agnostic on the geographical allocation of our equity positions. We focus on businesses with high cash returns on capital, with conservative capital structures and ideally an ability to reinvest cash in future growth at equally high rates of return. The US tends to offer us more opportunities to invest in these kind of businesses meaning that North America remains the largest geographical weighting within the equity allocation.

Emerging market equities: neutral

- Emerging markets have suffered from country specific risks, a strong US dollar and slowdown in China. Nevertheless, they should benefit from the benign rate environment. Therefore, we maintain a neutral position to the asset class

- While markets have grown increasingly cautious following heightened protectionism fears, emerging market equities should benefit from attractive valuations and steady economic activity out of the region, which will continue to underpin expansionary, albeit softening, growth.

Other assets: neutral

Alternative asset classes will continue to provide diversification to our portfolio, but are not expected to be the main drivers of returns. Gold is set to benefit from its status as a safe haven in the late cycle, and for this reason we maintained our allocation to the asset class. Conversely, real estate and alternative trading strategies are underpinned by a weak investment case.

Commodities: high conviction

- The sole exposure within commodities continues to be our position in gold which – in light of increasing headwinds for the global economy – we maintained our position in. We view this allocation as complementary to the other risk-mitigating assets in the portfolio

- We find little attraction in this asset class outside of precious metals and find our risk budget better deployed elsewhere.

Real estate: low conviction

- Real estate should continue to provide mild diversification benefits but we maintain a low conviction as the asset class looks expensive across different regions

- We expect loose monetary policies to favourably impact returns, although the asset class faces structural challenges from the rise of online retailers while weaker economic growth could be a headwind.

Alternative trading strategies: low conviction

- We maintain a low conviction in alternatives due to their high expense and a lack of investment opportunities in this space, although we do favour strategies that have low correlations to equity markets. The limited use of leverage should further cap returns for the asset class

- Nonetheless, sudden spikes in volatility, which are likely to materialise more often in a late-cycle environment, may lift the asset class at least in the short term.

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