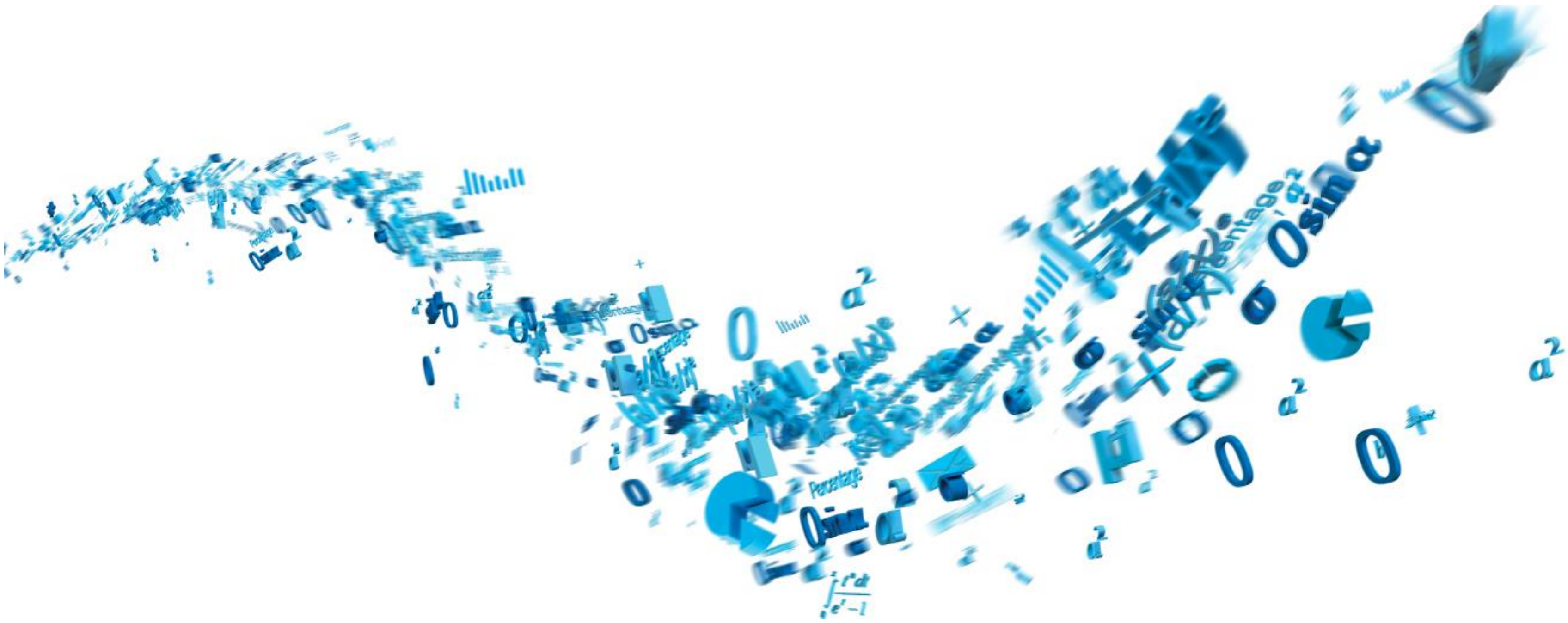


OPEB Discussion Guide

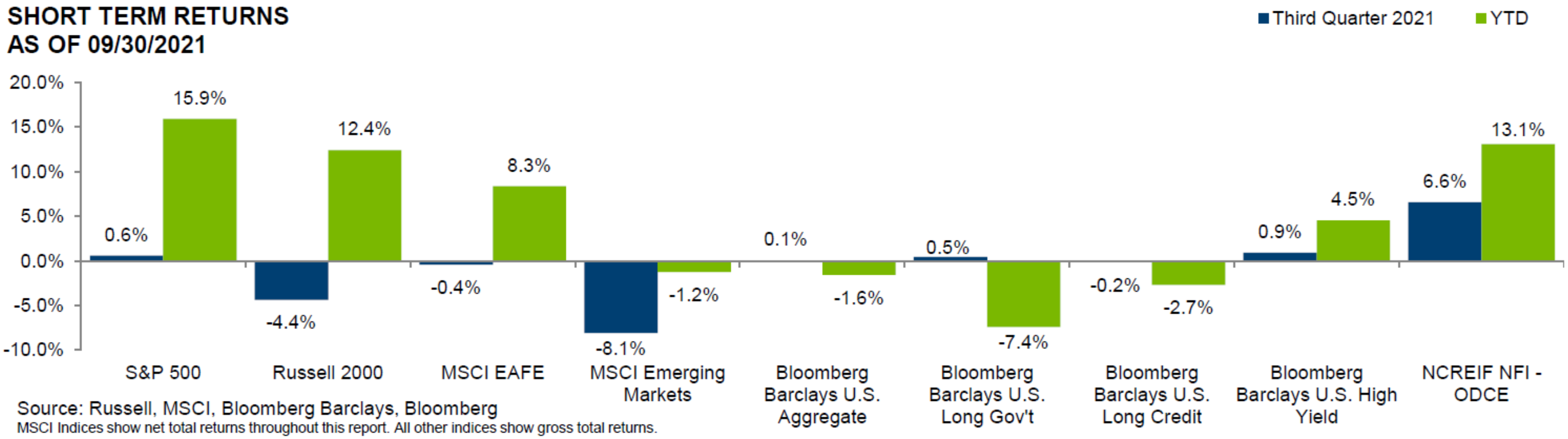
Town of Wilton
November 10, 2021

AON
Empower Results®

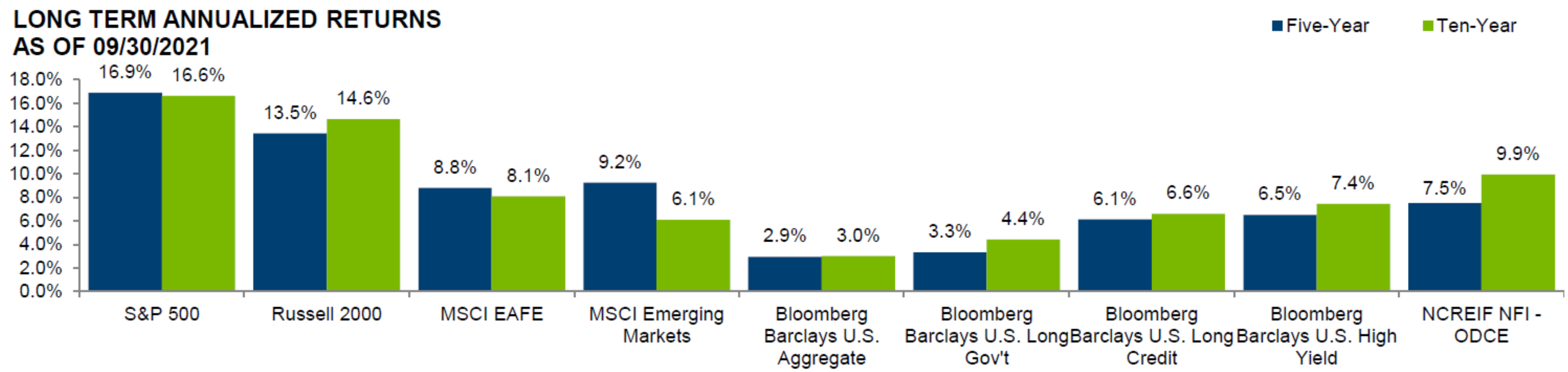
Contents

Executive Summary

Market Highlights



Source: Russell, MSCI, Bloomberg Barclays, Bloomberg
MSCI Indices show net total returns throughout this report. All other indices show gross total returns.



Source: Russell, MSCI, Bloomberg Barclays, Bloomberg

Market Highlights

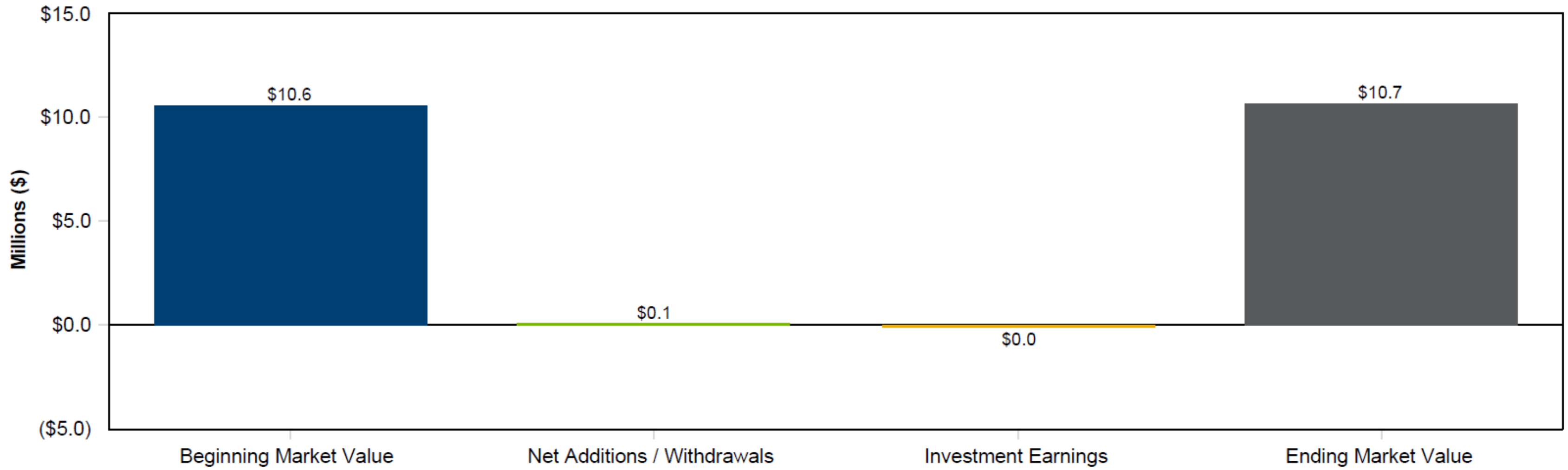
Returns of the Major Capital Markets						
Period Ending 09/30/2021	**Third Quarter**	**YTD**	**1-Year**	**3-Year[1]**	**5-Year[1]**	**10-Year[1]**
Equity						
MSCI All Country World IMI	-1.11%	11.42%	28.92%	12.38%	13.06%	11.96%
MSCI All Country World	-1.05%	11.12%	27.44%	12.58%	13.20%	11.90%
Dow Jones U.S. Total Stock Market	-0.12%	15.13%	32.13%	15.95%	16.82%	16.56%
Russell 3000	-0.10%	14.99%	31.88%	16.00%	16.85%	16.60%
S&P 500	0.58%	15.92%	30.00%	15.99%	16.90%	16.63%
Russell 2000	-4.36%	12.41%	47.68%	10.54%	13.45%	14.63%
MSCI All Country World ex-U.S. IMI	-2.56%	6.77%	25.16%	8.34%	9.13%	7.74%
MSCI All Country World ex-U.S.	-2.99%	5.90%	23.92%	8.03%	8.94%	7.48%
MSCI EAFE	-0.45%	8.35%	25.73%	7.62%	8.81%	8.10%
MSCI EAFE (Local Currency)	1.32%	14.23%	27.20%	7.16%	9.01%	10.10%
MSCI Emerging Markets	-8.09%	-1.25%	18.20%	8.58%	9.23%	6.09%
Equity Factors						
MSCI World Minimum Volatility (USD)	-0.09%	7.33%	13.56%	8.46%	9.27%	10.89%
MSCI World High Dividend Yield	-1.88%	8.99%	21.90%	7.76%	8.72%	9.80%
MSCI World Quality	0.12%	14.31%	26.34%	18.32%	17.92%	15.84%
MSCI World Momentum	1.07%	8.60%	20.12%	14.97%	18.11%	15.99%
MSCI World Enhanced Value	-0.80%	15.92%	36.99%	4.94%	8.53%	9.82%
MSCI World Equal Weighted	-0.40%	11.94%	31.44%	9.78%	11.12%	11.24%
MSCI World Index Growth	0.84%	12.21%	26.34%	19.56%	19.02%	16.01%
Fixed Income						
Bloomberg Barclays Global Aggregate	-0.88%	-4.06%	-0.91%	4.24%	1.99%	1.86%
Bloomberg Barclays U.S. Aggregate	0.05%	-1.55%	-0.90%	5.36%	2.94%	3.01%
Bloomberg Barclays U.S. Long Gov't	0.46%	-7.40%	-10.13%	9.17%	3.34%	4.40%
Bloomberg Barclays U.S. Long Credit	-0.18%	-2.66%	2.13%	10.20%	6.14%	6.59%
Bloomberg Barclays U.S. Long Gov't/Credit	0.07%	-4.57%	-2.97%	10.12%	5.21%	5.76%
Bloomberg Barclays U.S. TIPS	1.75%	3.51%	5.19%	7.45%	4.34%	3.12%
Bloomberg Barclays U.S. High Yield	0.89%	4.53%	11.28%	6.91%	6.52%	7.42%
Bloomberg Barclays Global Treasury ex U.S.	-1.56%	-6.81%	-2.47%	3.01%	0.61%	0.56%
JP Morgan EMBI Global (Emerging Markets)	-0.53%	-1.53%	3.88%	5.64%	3.57%	5.48%
Commodities						
Bloomberg Commodity Index	6.59%	29.13%	42.29%	6.86%	4.54%	-2.66%
Goldman Sachs Commodity Index	5.22%	38.27%	58.30%	-1.49%	3.64%	-4.83%
Hedge Funds						
HFRI Fund-Weighted Composite[2]	-0.03%	10.09%	22.09%	8.52%	7.31%	5.86%
HFRI Fund of Funds[2]	1.37%	6.38%	15.00%	6.72%	5.93%	4.53%
Real Estate						
NAREIT U.S. Equity REITS	0.98%	23.15%	37.39%	10.01%	6.83%	11.27%
NCREIF NFI - ODCE	6.59%	13.09%	14.59%	7.05%	7.50%	9.92%
FTSE Global Core Infrastructure Index	-1.20%	7.10%	14.84%	8.97%	8.79%	10.17%
Private Equity						
Burgiss Private iQ Global Private Equity[3]			53.27%	20.13%	18.26%	14.59%

MSCI Indices show net total returns throughout this report. All other indices show gross total returns.
[1] Periods are annualized.
[2] Latest 5 months of HFR data are estimated by HFR and may change in the future.
[3] Burgiss Private iQ Global Private Equity data is as at March 31, 2021

OPEB Performance Summary

Total Plan Asset Summary

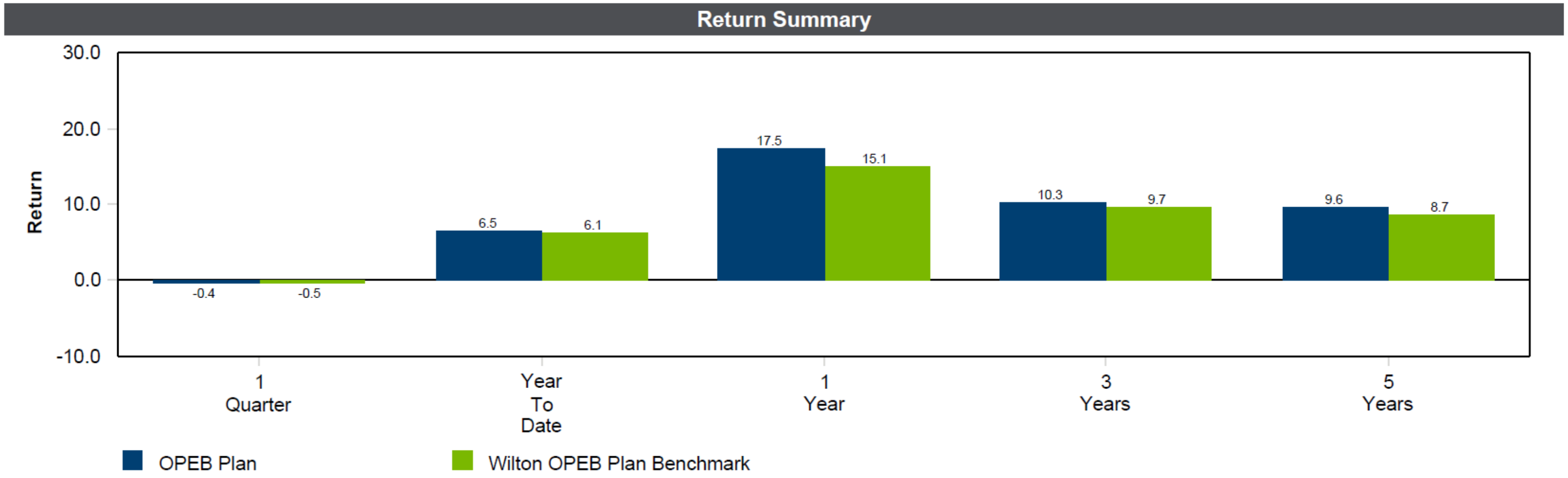
Change in Market Value
From July 1, 2021 to September 30, 2021

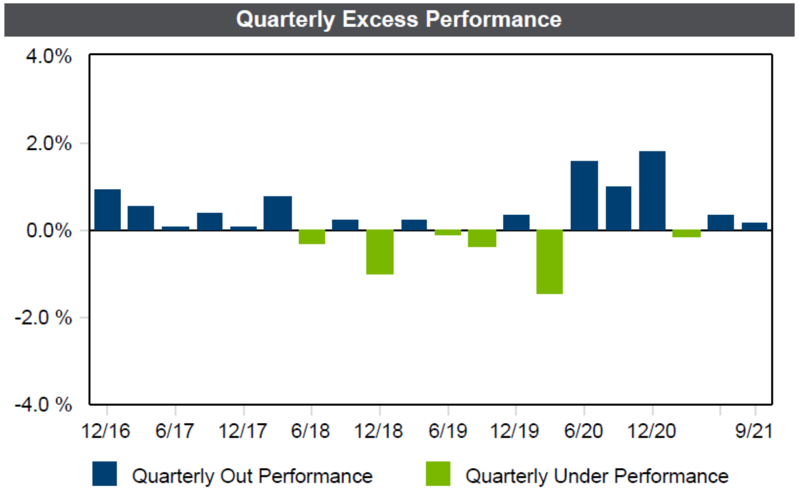


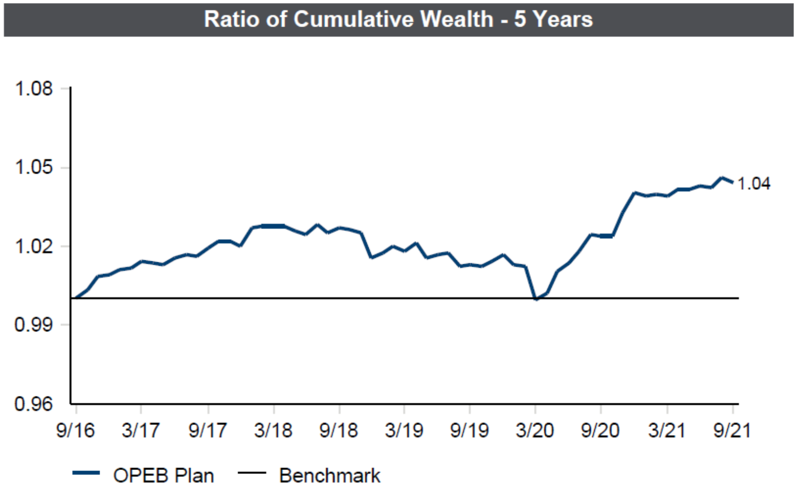
Summary of Cash Flow

	1 Quarter	1 Year	Since Inception	Inception Date
Beginning Market Value	10,647,224	9,200,253	2,652,035	
+ Additions / Withdrawals	93,387	-116,019	2,995,164	
+ Investment Earnings	-42,796	1,613,581	5,050,616	
= Ending Market Value	**10,697,815**	**10,697,815**	**10,697,815**	

Total Plan Performance Summary



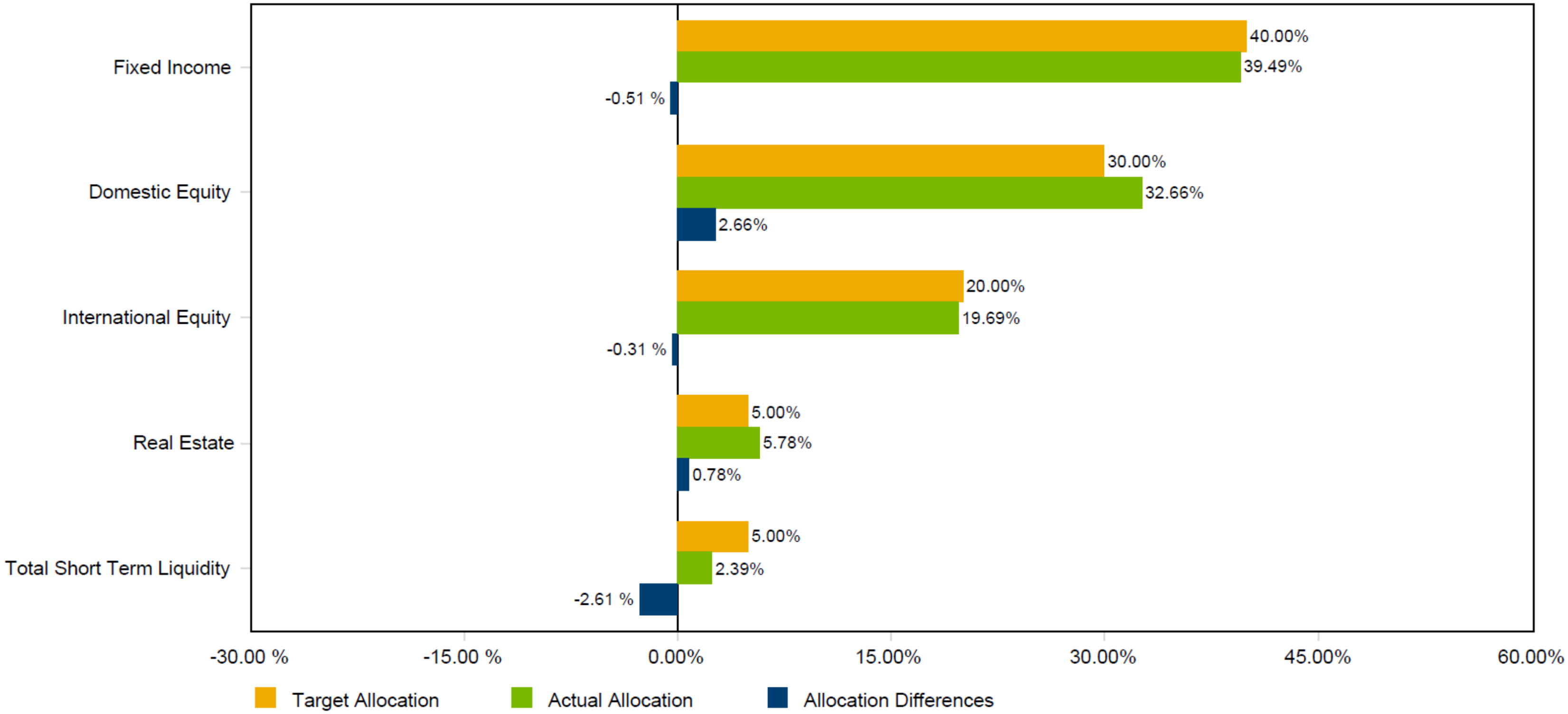




Empower Results®

Asset Allocation as of September 30, 2021

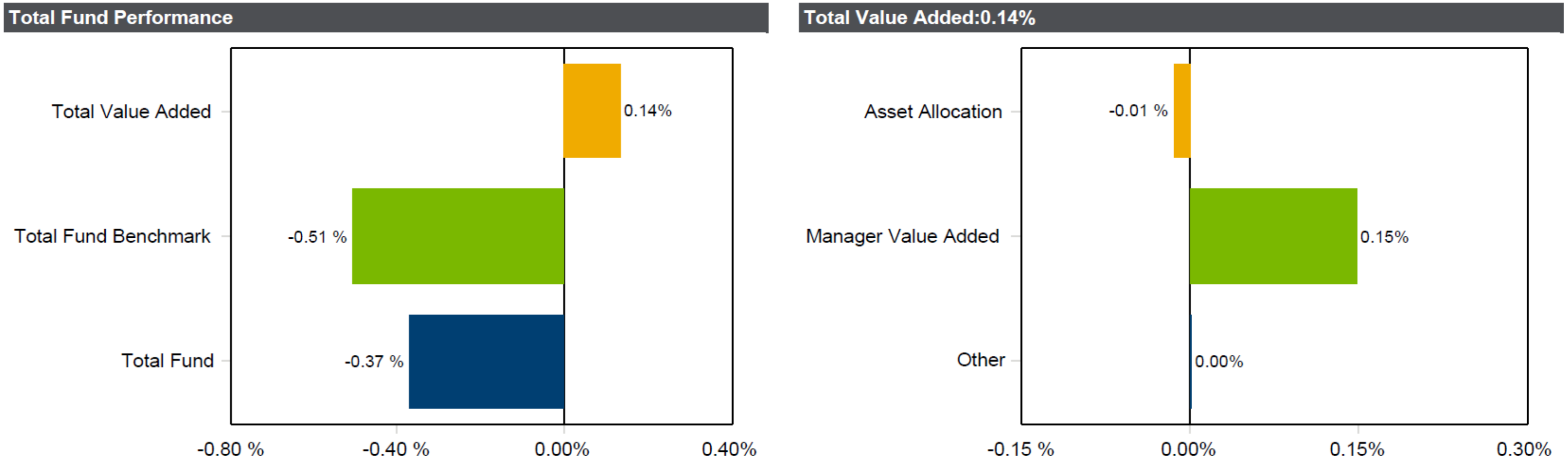
	Market Value ($)	Current Allocation (%)	Target Allocation (%)	Differences (%)
OPEB Plan	10,697,815.24	100.00	100.00	0.00
Fixed Income	**4,224,151.68**	**39.49**	**40.00**	**-0.51**
Domestic Equity	**3,493,641.04**	**32.66**	**30.00**	**2.66**
International Equity	**2,106,083.44**	**19.69**	**20.00**	**-0.31**
Real Estate	**618,723.66**	**5.78**	**5.00**	**0.78**
Total Short Term Liquidity	**255,215.42**	**2.39**	**5.00**	**-2.61**

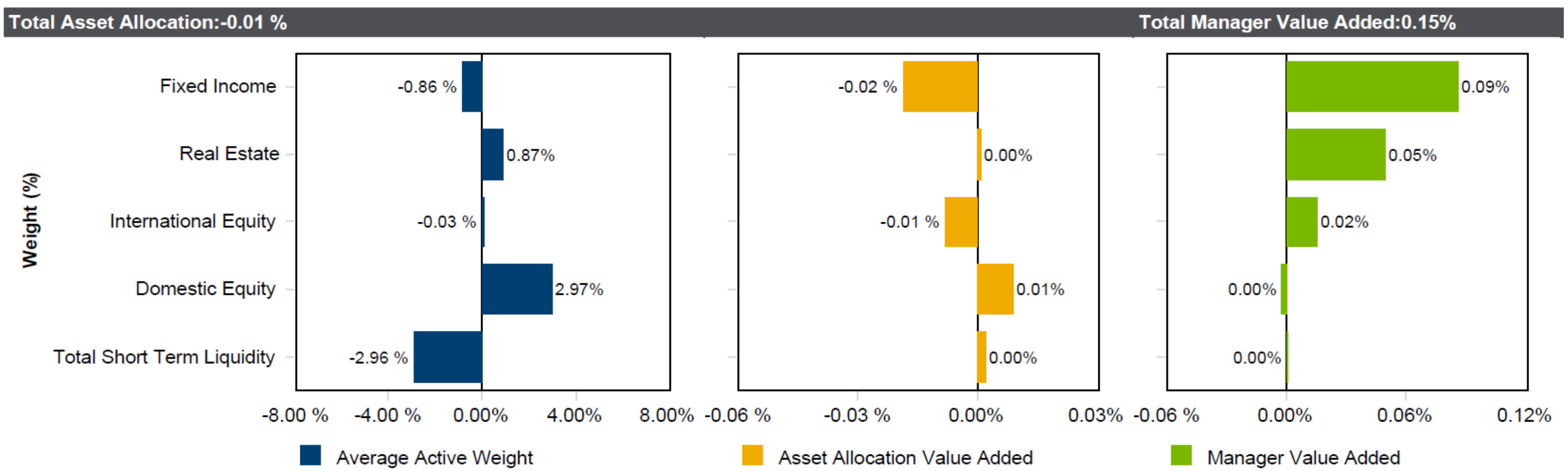


Empower Results®

OPEB Total Fund Attribution:
1 Quarter as of September 30, 2021

OPEB Plan vs. OPEB Total Plan Attribution





Empower Results®

Performance as of September 30, 2021

	Allocation			Performance(%)							
	Market Value ($)	%	Policy(%)	1 Quarter	Year To Date	1 Year	3 Years	5 Years	7 Years	Since Inception	Inception Date
OPEB Plan	10,697,815	100.0	100.0	-0.4	6.5	17.5	10.3	9.6	8.0	8.2	05/01/2012
Wilton OPEB Plan Benchmark				*-0.5*	*6.1*	*15.1*	*9.7*	*8.7*	*7.4*	*7.6*	
Fixed Income	**4,224,152**	**39.5**	**40.0**	**0.3**	**-0.3**	**1.5**	**4.8**	**3.8**	**3.4**	**3.8**	**07/01/2010**
OPEB Fixed Income Composite Benchmark				*0.1*	*-1.6*	*-0.9*	*5.3*	*2.9*	*3.2*	*3.3*	
Vanguard Total Bond Market Index Adm	1,068,133	10.0		0.1 (34)	-1.6 (78)	-0.9 (84)	5.4 (63)	2.9 (71)	3.2 (64)	4.1 (70)	06/01/2019
Blmbg. U.S. Aggregate				*0.1 (55)*	*-1.6 (76)*	*-0.9 (82)*	*5.4 (65)*	*2.9 (70)*	*3.3 (63)*	*4.1 (72)*	
IM U.S. Broad Market Core Fixed Income (MF) Median				0.1	-1.1	0.2	5.6	3.3	3.5	4.6	
Metropolitan West Total Return Bond Pl	856,587	8.0		0.1 (51)	-1.0 (70)	0.3 (82)	6.2 (36)	3.6 (70)	3.6 (63)	5.0 (51)	06/01/2019
Blmbg. U.S. Aggregate				*0.1 (71)*	*-1.6 (90)*	*-0.9 (98)*	*5.4 (80)*	*2.9 (93)*	*3.3 (89)*	*4.1 (90)*	
IM U.S. Broad Market Core+ Fixed Income (MF) Median				0.1	-0.5	1.3	6.0	3.8	3.8	5.1	
PGIM Total Return Bond R6	657,208	6.1		0.0 (84)	-1.4 (85)	0.9 (61)	6.3 (31)	4.0 (34)	4.3 (21)	4.7 (27)	12/01/2015
Blmbg. U.S. Aggregate				*0.1 (71)*	*-1.6 (90)*	*-0.9 (98)*	*5.4 (80)*	*2.9 (93)*	*3.3 (89)*	*3.5 (93)*	
IM U.S. Broad Market Core+ Fixed Income (MF) Median				0.1	-0.5	1.3	6.0	3.8	3.8	4.2	
PIMCO Income Fund	1,642,224	15.4		0.6 (25)	2.4 (36)	7.0 (36)	5.7 (48)	5.3 (13)	5.2 (11)	2.1 (37)	02/01/2021
Blmbg. U.S. Aggregate				*0.1 (71)*	*-1.6 (95)*	*-0.9 (99)*	*5.4 (56)*	*2.9 (87)*	*3.3 (76)*	*-0.8 (97)*	
IM Multi-Sector General Bond (MF) Median				0.2	1.7	5.6	5.6	4.4	4.0	1.4	
Domestic Equity	**3,493,641**	**32.7**	**30.0**	**-0.1**	**15.2**	**32.1**	**16.1**	**16.9**	**14.0**	**15.8**	**07/01/2010**
OPEB Domestic Equity Benchmark				*-0.1*	*15.2*	*32.1*	*16.1*	*16.9*	*14.0*	*15.8*	
Vanguard Total Stock Market Index Adm	3,493,641	32.7		-0.1 (40)	15.2 (51)	32.1 (46)	16.0 (18)	16.9 (17)	13.9 (10)	15.7 (14)	01/01/2012
*Vanguard Spliced Total Stock Market Index **				*-0.1 (40)*	*15.2 (51)*	*32.1 (45)*	*16.1 (18)*	*16.9 (16)*	*14.0 (10)*	*15.7 (14)*	
IM U.S. Multi-Cap Core Equity (MF) Median				-0.3	15.2	31.7	13.7	14.7	11.8	14.3	

*Consists of Dow Jones U.S. Total Stock Market Index (formerly known as the Dow Jones Wilshire 5000 Index) through April 22, 2005; MSCI US Broad Market Index through June 2, 2013; and CRSP US Total Market Index thereafter. ** Total International Composite Index through August 31, 2006; MSCI EAFE + Emerging Markets Index through December 15, 2010; MSCI ACWI ex. U.S. IMI Index through June 2, 2013; FTSE Global All Cap ex U.S. Index thereafter *** Consists of MSCI US REIT Index adjusted to include a 2% cash position (Lipper Money Market Average) through April 30, 2009; MSCI US REIT Index through January 31, 2018; MSCI US Investable Market Real Estate 25/50 Transition Index thereafter.

Performance as of September 30, 2021

	Allocation			Performance(%)							
	Market Value ($)	%	Policy(%)	1 Quarter	Year To Date	1 Year	3 Years	5 Years	7 Years	Since Inception	Inception Date
International Equity	**2,106,083**	**19.7**	**20.0**	**-2.7**	**5.2**	**24.6**	**10.9**	**10.7**	**7.6**	**8.9**	**07/01/2010**
OPEB International Equity Composite Benchmark				*-2.7*	*6.4*	*24.6*	*8.3*	*9.1*	*5.9*	*7.3*	
Vanguard Total International Stock Index Adm	1,060,158	9.9		-3.0 (65)	6.4 (70)	24.4 (70)	8.3 (17)	9.0 (12)	6.0 (20)	6.9 (44)	05/01/2012
*Vanguard Spliced Total International Stock Index ***				*-2.5 (61)*	*6.9 (58)*	*25.4 (64)*	*8.5 (16)*	*9.3 (8)*	*6.2 (10)*	*6.9 (40)*	
IM International Large Cap Core Equity (MF) Median				-2.4	7.5	26.2	6.7	7.8	4.8	6.8	
American Funds EuroPacific Growth R6	1,045,926	9.8		-2.3 (50)	4.0 (92)	24.8 (68)	13.2 (1)	12.2 (1)	9.0 (1)	8.5 (1)	09/01/2014
MSCI AC World ex USA Index (Net)				*-3.0 (65)*	*5.9 (77)*	*23.9 (72)*	*8.0 (20)*	*8.9 (13)*	*5.7 (29)*	*4.9 (33)*	
IM International Large Cap Core Equity (MF) Median				-2.4	7.5	26.2	6.7	7.8	4.8	4.1	
Real Estate	**618,724**	**5.8**	**5.0**	**1.1**	**20.9**	**32.0**	**11.5**	**7.3**	**9.3**	**11.0**	**07/01/2010**
OPEB Real Estate Benchmark				*0.2*	*21.6*	*31.5*	*11.7*	*8.4*	*10.0*	*12.0*	
Cohen & Steers Institutional Realty Shares	618,724	5.8		1.1 (46)	22.9 (33)	33.5 (47)	14.1 (15)	9.6 (12)	11.2 (9)	23.7 (30)	02/01/2021
FTSE NAREIT All Equity REITs				*0.2 (85)*	*21.6 (59)*	*31.5 (64)*	*11.7 (49)*	*8.4 (32)*	*10.0 (29)*	*21.7 (65)*	
IM Real Estate Sector (MF) Median				1.0	22.0	33.4	11.5	7.6	9.3	22.4	
Total Short Term Liquidity	**255,215**	**2.4**	**5.0**	**0.0**	**0.5**	**0.5**	**0.9**	**0.8**	**0.6**	**0.5**	**01/01/2012**
Wells Fargo Government MM Fund	132,956	1.2		0.0	0.6	0.6	1.2	1.1	0.8	0.6	04/01/2012
90 Day U.S. Treasury Bill				*0.0*	*0.0*	*0.1*	*1.2*	*1.2*	*0.9*	*0.6*	
Webster Cash	122,259	1.1									

*Consists of Dow Jones U.S. Total Stock Market Index (formerly known as the Dow Jones Wilshire 5000 Index) through April 22, 2005; MSCI US Broad Market Index through June 2, 2013; and CRSP US Total Market Index thereafter. ** Total International Composite Index through August 31, 2006; MSCI EAFE + Emerging Markets Index through December 15, 2010; MSCI ACWI ex. U.S. IMI Index through June 2, 2013; FTSE Global All Cap ex U.S. Index thereafter *** Consists of MSCI US REIT Index adjusted to include a 2% cash position (Lipper Money Market Average) through April 30, 2009; MSCI US REIT Index through January 31, 2018; MSCI US Investable Market Real Estate 25/50 Transition Index thereafter.

Aon Medium Term Views

Core Views

The outlook is more challenging

The market is trying to digest the prospect of higher inflation and lower growth looking into 2022.

Persistent inflation risk is key to market turbulence

Production costs, including wages are a problem going into 2022. If pressures remain this will create:

- Margin pressures
- US yield curve shifts as rate expectations shift higher and liquidity starts to shrink
- Expectations of a step down in economic and profits growth

Large market falls may not be imminent

We stress that our less constructive view on the markets is not a prediction of a large market fall imminently. Timing such an event accurately is, in any case, impossible. Our view reflects the gradual erosion of market supports rather than a sudden step change in conditions.

View shifts

Downgraded equities view

More defensive regional and style views too. Value and emerging markets downgraded, low volatility upgraded

More defensive credit views

Emerging market debt views downgraded, whilst the high yield view is downgraded further

Actions

Being sparing with equity risk in portfolios

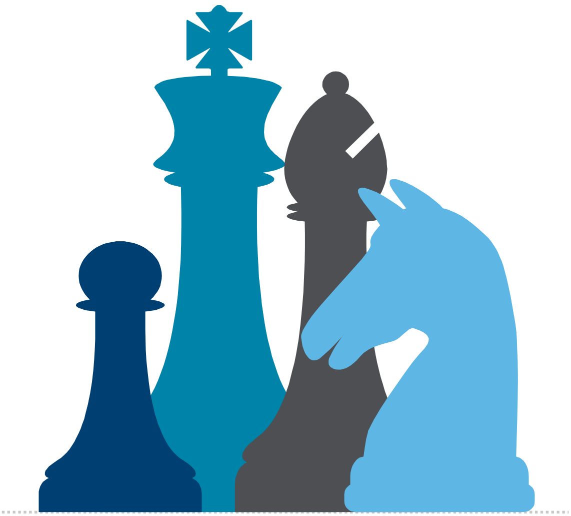
- Dependent on equity exposure, there are several options available. Reducing equity exposure for those with high weightings, adding direct equity protection and exploring diversifiers are all on the table.

Be selective in credit markets

- Rising yields and spread risks are bringing return challenges so selectivity is essential.

Diversifiers review

- This is a good time to see which of the existing diversifiers in a portfolio might be expected to perform well and whether some reinforcing is required.



Objective

Portfolios should focus on managing the risk/reward challenge of current high asset valuations and high correlations between assets.

Empower Results®

Recommended actions

Total Return Cross Asset Class Views

---	--	-	=	+	++	+++
		Equities		Alternatives		
		Core fixed income		Cash		
		Credit				

Equity view downgraded due to increasing headwinds from inflation, tightening policy and a weakening recovery

We favor uncorrelated sources of return. Holding some cash is reasonable now given return profiles for stocks and bonds

Relative Asset Class Views

Equity Regions

---	--	-	=	+	++	+++
			USA			
			EAFE			
			Emerging			

Regional views neutralised as the outlook for equities becomes more uncertain

Chinese slowdown and global headwinds prompt a downgrade in the EM view

Credit

---	--	-	=	+	++	+++
	High Yield	USD EMD	Bank Loans	Selected ABS		
		Local EMD				

Credit spreads remain very tight and our updated macro view has prompted a further HY downgraded

EM assets downgraded. Cooling Chinese growth and US dollar strength mean overseas investors will have lower appetite to invest in EM despite higher yield levels

Equity Styles

---	--	-	=	+	++	+++
		Value	Low Vol.			
		Growth	Quality			

Value downgraded and Low volatility upgraded amid a more defensive stance

Core Fixed Income Duration*

---	--	-	=	+	++	+++
			Treasuries			
			Inv. Grade			
			TIPS			

We still lean negative on duration

No preference between nominal and inflation-linked bonds

Alternatives

---	--	-	=	+	++	+++
			Commodities	Diversifying Hedge Funds		
			Real Estate	Global Infra.		
				Private Credit		

Non-correlated alternatives still generally preferred

Currencies versus USD

---	--	-	=	+	++	+++
			EUR			
			GBP			
			JPY			
			EM			

US dollar may be supported near-term by growth and interest rates, but we are less positive over the next few years

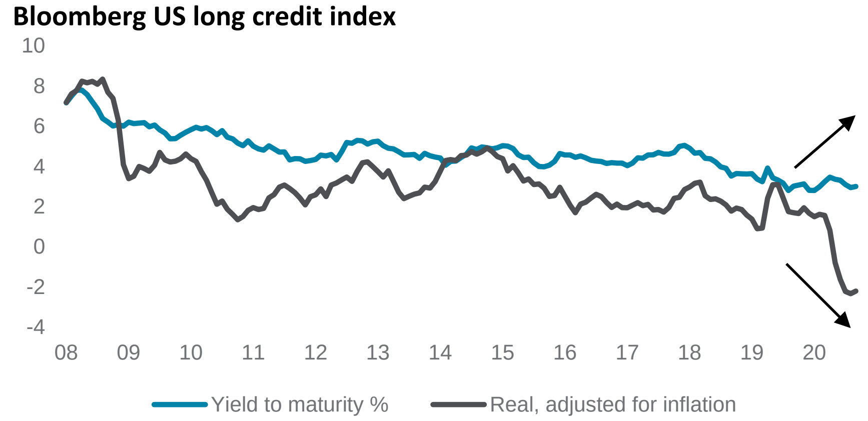
* Please refer to Page 11 for detailed global views
Please refer to the end of the document for interpretation guidelines

Equities

The key supports for equities are slowly losing their potency – view downgraded

- Equity markets have found the going increasingly difficult as the summer months have given way to autumn. Rising inflation, coupled with mounting concern that monetary and fiscal policy are moving firmly into tightening mode, have hurt momentum. We think that the medium-term outlook has darkened.
- We think that the key pinch-point for equities is a changing macroeconomic growth-inflation balance. The persistence of inflationary pressures into 2022 could squeeze margins, threaten a higher interest rate trajectory and weaken spending by consumers and businesses. Consensus market views are only now beginning to allow for these risks.
- Conversely, if interest rates fall from here, the likely trigger will be weaker economic conditions, confirming that the recovery from the pandemic is already over. Equity investors will not greet this positively, of course.
- Analyst earnings revisions look like they have peaked and, while earnings forecasts (and results) have been strong this year, expectations are at much more normal levels. We feel that the risks to these expectations are towards the downside.
- It is important to note that we are not necessarily expecting an imminent strong market downturn. There are still important supports in the form of market sensitive central banks, pent-up demand and the prospect of further virus control progress.
- However, we believe that the balance is no longer clearly in favour of equities now, hence our view downgraded.

Yields are becoming less of a tailwind for stocks



Source: Bloomberg, Aon

Earnings revisions look likely to have peaked

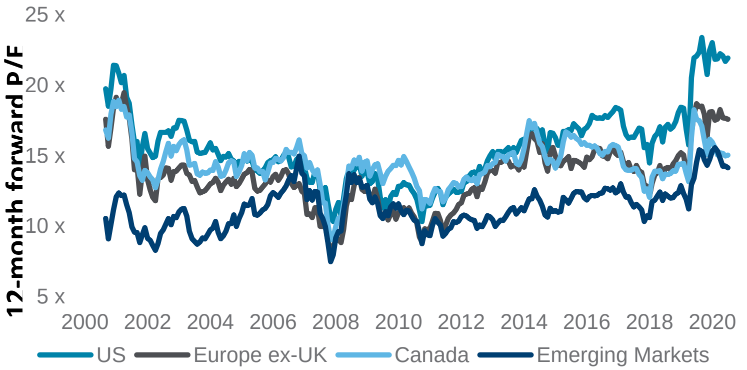
Source: Factset, Aon

Equities

Moving more defensive by downgrading value view and upgrading low volatility

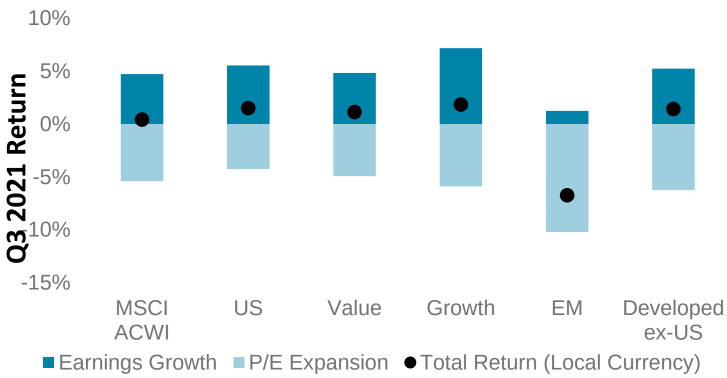
- As overall equity performance has struggled over Q3, so have the regions, with most developed markets delivering very muted or negative returns. The clear underperformer was Emerging Markets, which suffered from rising yields, supply chain issues, a global risk off environment and, most recently, the Chinese regulatory crackdown.
- We have decided to move our regional views further into an agnostic stance, downgrading our Emerging Markets view. If our outlook of weakening equity supports is correct, EM equities will not be spared from the headwinds in our opinion. At the same time, China dominates the EM indices, and all the signs point to a material growth slowdown there now.
- In terms of styles, we think it is now appropriate to move to a more defensive stance. Value stocks tend to perform better in a rising yield environment, but we believe that higher yields will be driven more by inflation than growth expectations. Such a backdrop could help energy and financial stocks, but this would likely be in the context of struggling markets in general. This is why we have downgraded our value view to be in line with our growth stock view. At the same time, the chances of spikes in volatility have risen, which has prompted the upgrade to our low volatility equity view.

Valuation gaps are large but upward momentum has waned



Source: Factset, MSCI, Aon

Emerging markets have suffered the most over Q3, with value and growth returns similar



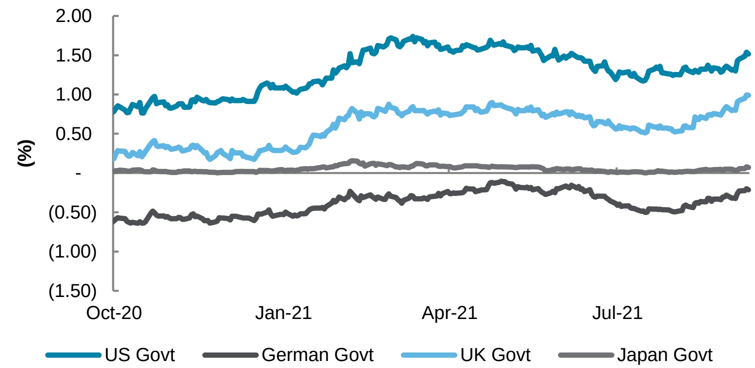
Source: Factset, MSCI, Aon. Changes in the 12-month forward P/E and earnings per share shown. Local currency returns and MSCI World Growth and Value indices shown.

Empower Results®

Government bonds
Further yield rises likely

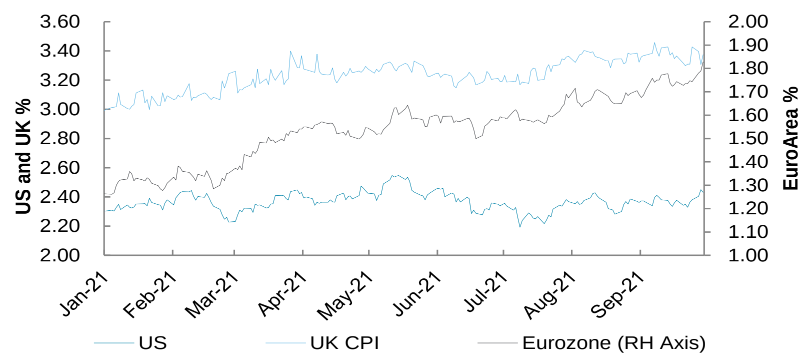
- Nominal yields have moved sharply higher in most developed economies, with the move in the UK being particularly elevated. Since Q2, bond markets seem to have largely been relaxed about the spike in inflation, with the view that it is transitory largely dominant. Forward starting inflation swaps which avoid the impact of the spike in recent inflation remain subdued.
- We believe that the Fed will start ‘tapering’ in November and finish asset purchases in the summer of 2022. The interest rate hiking process remains planned for late next year at the earliest but Fed officials have become a little more uncomfortable with inflation and have already stated that it may persist longer than previously thought.
- There could be a return to term premia in order to attract a private sector bid in the market. There is also the danger that markets over-extrapolate the first few hikes by central banks and this also leads to sharply higher yields. Offsetting this in the near-term is the risk of lower than expected fiscal stimulus – the Democrats’ infrastructure bill is looking increasingly likely to be watered down and debt ceiling talks are going to the wire once again – and a surprisingly weaker economy next year.
- We think that Treasury bonds are likely to continue to underperform over the medium term and we maintain a moderate short-duration preference.

10Y Yields Rebound as Inflation Remains High



Source: Bloomberg

Outside the Euro-Area Longer-term Inflation Remains Subdued



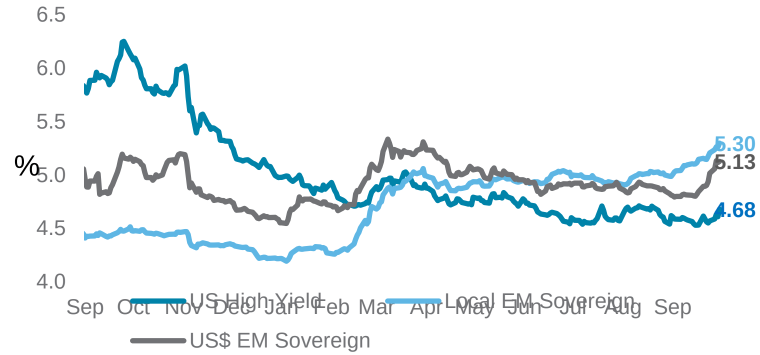
Source: Bloomberg

Credit

We are downgrading EM debt as part of our more defensive stance. We still prefer loans to HY bonds.

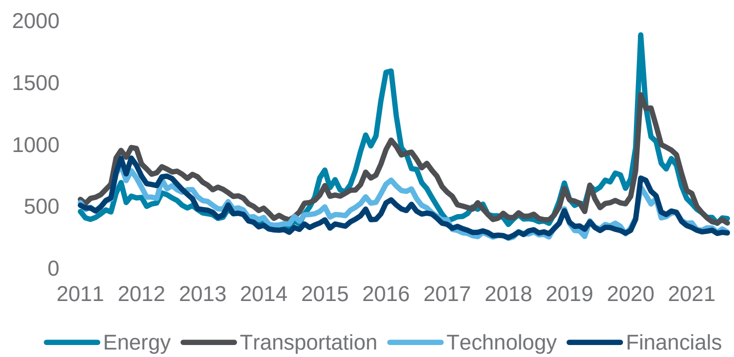
- Local EM bond underperformance has partly occurred due to Emerging economies' inflation sensitivity to rising energy and agricultural prices which offsets the beneficial impact of rising commodity prices to EM exporters. Cooling Chinese growth and US dollar strength also mean that overseas investors have little appetite to invest in EM in spite of higher yield levels.
- In line with our more defensive stance, we expect risk aversion to continue and we are therefore downgrading EM debt in spite of relatively cheap valuations, improved EM fundamentals than in the past and our view that inflation, US yield rises and a strong dollar are not big threats over the next few years. We are keeping a neutral view between riskier local and US$ EM debt as we think that local EM debt yields and currency valuations already price in a defensive position.
- US high yield (HY) bond credit spreads have continued to narrow to ever tighter levels although concerns over the delta virus, supply chain issues and wage inflation have caused the pace of compression to slow over the summer. The sectors that suffered most in the pandemic have more than fully recovered as reflected by their credit spread level which underlines to us that HY bonds offer little appeal in this environment.
- Tighter US monetary policy expectations are resulting in strong US retail and CLO inflows into bank loans given their lower duration than HY bonds. This should offset record high PE-backed issuance in the demand/supply tug-of-war. We continue to prefer loans to HY bonds for this reason and their greater defensiveness in risk-off periods.

Local EM debt yields have risen above US$ credit sector yields



Source: Factset, JPMorgan

Covid-19-hit US HY sector credit spreads are now tighter vs other sectors than pre-pandemic



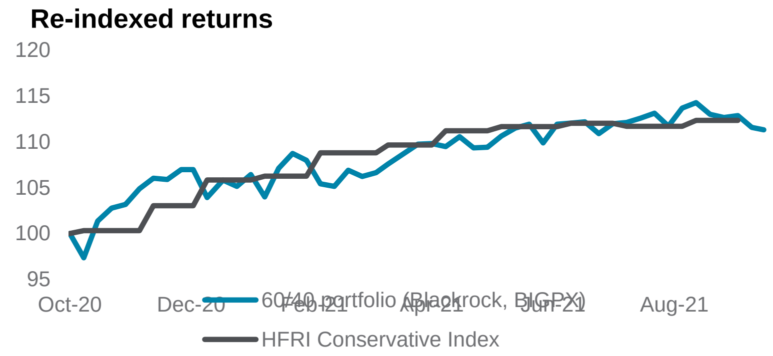
Source: BofA Securities

Alternatives

Challenged returns from 60/40 portfolio helps the relative outlook for diversifying hedge funds

- The standard balanced 60-40 portfolio has delivered very strongly in the past 5 years, annualised returns exceeding double digits.
- However, we may be in a period when pressures on bonds and equities lead to a period of much lower returns for this 60-40 mix.
- This benefits the relative outlook for defensive or diversifying hedge funds. The HFRI conservative index, a combination of defensive hedge fund strategies like equity market neutral and fixed income arbitrage (which are less dependent on rising markets) is a good point of comparison with the traditional 60/40 index – underperforming in absolute (though equivalent on a risk-weighted) terms over several years, but now on a better relative footing looking ahead (see chart).
- Other alternatives, though illiquid in comparison to hedge funds, are also likely to provide some diversification to portfolios – private real estate and infrastructure are two of our favoured choices at present.

Are defensive/diversifying hedge funds coming into their own?



Source: Bloomberg

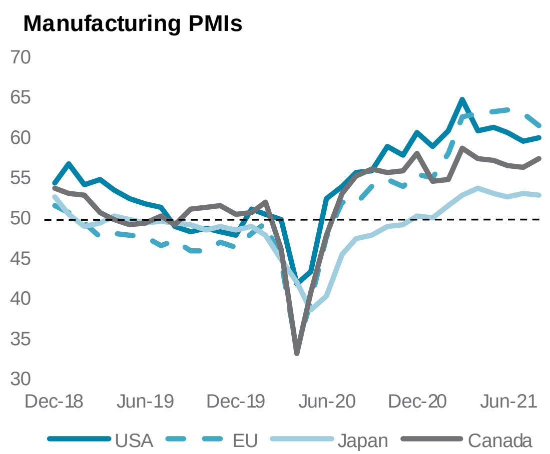
Appendix

Empower Results®

Economic highlights

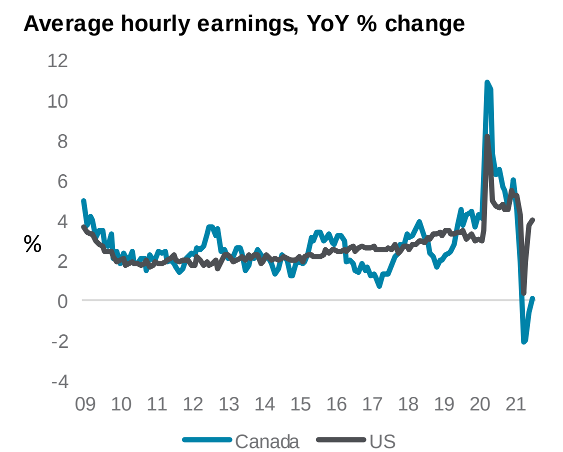
Economic growth continued to be reasonably robust over the quarter, with Europe outpacing the US in response to the easing of restrictions and a rapidly accelerating vaccination programme. In contrast, whilst the US has lived with lower restrictions for longer, a lower vaccination rate has so far resulted in sharply rising infections from the delta variant. Meanwhile, inflation has risen further to multi-year highs as supply chain problems continue to reverberate around the world. Central banks did not change their view that these problems would settle down over time but they also clearly moved closer to tightening monetary policy, first by tapering Quantitative Easing, then raising interest rates. In terms of fiscal policy, the period of significant net spending is coming to a close and the talk is beginning to turn towards tax rises in some economies. Whilst a recession is unlikely, we think that developed world growth will lose further momentum over the coming year. Emerging market activity, by contrast, will be driven by the pandemic and the easing of supply chain bottlenecks.

Has the recovery peaked?



Supply chain issues remain significant

Wage growth has accelerated in recent months



Sources for charts: Factset

Empower Results®

Economic highlights

USA

- The recovery continued apace through Q2, with GDP growth reported to have grown at a quarterly annualised rate of 6.6%, compared with Q1's 6.4%. Over Q3, there have been some signs of peaking in the rate of recovery, as could be seen in the ISM manufacturing and services indexes. The August payrolls report also disappointed expectations, amid evidence that consumers were reducing their spending on the hospitality and travel sectors.
- Meanwhile, inflation remained near a multi-year high at 5.3% in August, but this still represented a small fallback compared with July. It is likely that inflation remains elevated for several more months but, assuming that supply chain issues are resolved over time and demand moderates, it likely to trend lower. The risk is that inflation remains higher than currently expected, however.
- The Fed also continues to believe that inflation will moderate and remained in no hurry to tighten policy, but it did bring forward the date of tapering and interest rate increases a little. Tapering may begin in November, whilst the first interest rate hike is now pencilled in for the end of next year.

EAFE

- The Eurozone economy bounced back in the second quarter, growing by 2.2% following two consecutive quarters of decline. Indeed, Europe has suffered especially from the pandemic and lockdowns. However, a rapid vaccination programme and the lowering of restrictions have boosted consumer spending, which has continued in Q3. With inflation rising sharply, the ECB has inched closer to tightening monetary policy.
- In Japan, PM Yoshihide Suga decided to step down after only 1 year in the job due to low popularity ratings. Meanwhile, restrictions were set to be reduced across the country in response to falling infection rates. Japan's recovery has so far been muted and will be further challenged by the likely slowdown in China and continued chip shortages.
- In the UK, the economy expanded by 4.8% in Q2 – the fastest rate in the G7 – but the recovery already seems to be fading. GDP grew by only 0.1% in July and logistical and energy cost issues are likely to persist into the winter. The Bank of England stands ready to tighten policy in response to surging inflation, but also acknowledges weaker economic growth, so tightening will likely be very gradual, just like elsewhere.

Emerging Markets

- The Chinese economy remained relatively strong over the summer but there have been mounting issues in the housing, energy and technology sectors that are becoming an increasing headwind to future growth. Much of this has been triggered by new regulations and priorities from the government but these have triggered a probable default by a major property firm and energy shortages that have closed some factories. It is possible that these headwinds continue in the coming months.
- The slowdown in the Chinese economy will have an important impact on Asian activity and emerging markets in general, given its dominance. Counterbalancing these negative trends will likely be higher commodity prices for exporters and possible higher demand from the developed countries. Nonetheless, high inflation is also a threat to domestic demand and central banks will be faced with the conundrum of supporting growth and reacting to the rising cost of living. The Turkish central bank's decision to cut its policy rate despite rapidly rising inflation is a case in point, which triggered a sharp depreciation in the currency.

View guidance

- - -

Large under-performance expected with highest conviction

- Target larger underweight
- Bring forward selling plans and defer SAA buying implement-ation
- Do not rebalance to target weight yet

- -

More under-performance or stronger conviction

- Target underweight
- Bring forward selling plans and defer SAA buying implement-ation
- Do not rebalance up to target weight yet

-

More likely to underperform

- Target small underweight to strategic weight
- Prefer to avoid buying and selling on strength
- Buying for SAA reasons fine, but add slowly or into weakness.
- Consider partial rather than full rebalancing

=

Weak conviction or no view on relative performance

- Target benchmark or strategic weight
- Buying/ Selling both look ok coming from SAA changes or rebalancing

+

More likely to outperform

- Target small overweight to strategic weight
- Prefer to accumulate
- Selling for SAA reasons fine, but look to sell gradually
- Slow rebalancing moves back to benchmark weight

++

More outperformance or stronger conviction

- Target overweight
- Bring forward buying plans and defer SAA selling implement-ation
- Do not rebalance down to target weight yet

+++

Large outperformance expected with highest conviction

- Target larger overweight
- Bring forward buying plans and defer SAA selling implement-ation
- Do not rebalance to target weight yet

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