

## Uncommon truths

### What could prevent a further collapse in US stocks?

**The VIX is at 45 which is often a good signal for US stocks. However, it feels as though US stocks and the economy risk falling into a negative feedback loop. I think rapid negotiations to limit US tariffs and Fed easing would help but I remain cautious.**

Financial markets reacted swiftly to the “Liberation Day” announcement of US reciprocal tariffs on 2 April 2025, reactions that were aggravated by China’s announcement on 4 April of a 34% retaliatory tariff on US goods. **Figure 1** shows there was a brutal two day decline in most stock indices after the US announcement, led by the US market (note that Chinese markets were closed on the second of those days, while Taiwan was closed on both days).

Other bearish signals came from copper (-10% in two days, based on LME 3-month futures) and Brent crude (-13% based on 3-month futures). Admittedly, the decline in Brent was exacerbated by the OPEC+ announcement on 4 April 2025 that oil production would rise in May by more than expected. Interestingly, the US dollar has weakened against most major currencies over the last week (see **Figure 3**), a trend that we expect to continue (see [FX Pulse](#)).

That is a pretty good template for how I would expect markets to behave in a global slowdown sparked by

US recession. The obvious exception is gold, which I would normally expect to benefit from falling US treasury yields and a weakening dollar (and a ramping up of global tensions). That it has weakened may suggest a lot of the bad news about tariffs was already in the price (see [Why is gold at \\$3000?](#)).

Where things go from here will depend critically upon the intention behind the US reciprocal tariffs, in my opinion. It is tempting to believe they are simply a basis for negotiation with other countries, the aim being to win concessions for the US. The problem is that it is not obvious what other countries can negotiate away. **Figure 1** shows that in most cases the tariffs imposed on US goods by trading partners are not out of line with those imposed by the US, with the exceptions of Taiwan and South Korea (the table shows a selection of countries targeted for the highest reciprocal tariffs). As made clear by **Figure 1**, the reciprocal tariffs imposed by the US were literally based on the size of the imbalance with each country, rather than any real analysis of obstacles to trade (compare columns 1 and 2). If the US deficit simply reflects its own imbalances (too little savings versus investment) and the fact that it produces too few goods at a price that the rest of the world wants to pay, there is not a lot that trade partners can do to help. It will be hard to negotiate when confronted by that logic.

**Figure 1: US tariffs, potential economic consequences and stock market reactions for a selection of the most impacted countries**

	Goods surplus with US/2 (% of imports)	Reciprocal tariff (%)	WTO tariff imposed on US (%)	WTO tariff imposed by US (%)	Economic impact (%)	Share price index change since 2 April 2025 (%)
<b>Vietnam</b>	45.2	46	2.9	3.2	12.1	-8.4
<b>China</b>	33.6	34	4.9	2.4	0.5	-1.7
<b>Taiwan*</b>	31.7	32	6.5		3.1	0.0
<b>Switzerland</b>	30.0	31	0.2	1.4	1.3	-7.4
<b>India</b>	26.1	27	6.2	2.4	0.3	-2.2
<b>S. Korea</b>	24.9	25	15.0	1.7	0.9	-2.4
<b>Malaysia</b>	23.8	24	1.5	0.7	1.4	-1.6
<b>Japan</b>	23.0	24	1.5	1.6	0.4	-6.6
<b>EU</b>	19.4	20	1.7	1.4	0.2	-7.6
<b>Israel</b>	15.3	17	0.7	0.8	0.2	-5.0
<b>US**</b>				1.5		-10.6

Notes: **Past performance is no guide to future results.** “Goods surplus with US/2 (% of imports)” is our shorthand version of the calculation used by the Office of the United States Trade Representative (USTR) to determine the reciprocal tariff to be imposed on trading partners. It is assumed by USTR that the notional tariff used by the trade partner is equal to that country’s surplus in goods with the US divided by imports from that country (adjusted by factors for the elasticity of imports with respect to prices and the passthrough from tariffs to import prices). The “Reciprocal tariff” was then set by USTR at roughly half of that rate. “WTO tariff imposed on US” shows the weighted average of tariffs imposed on US goods in 2024 (weighted by import values for each good). “WTO tariff imposed by US” shows the weighted average tariff imposed by the US on the partner country in 2024 (weighted by import values for each good). Tariff data is sourced from WTO tariff and trade data. “Economic impact” is the reciprocal tariff multiplied by the trade surplus with the US in 2024 divided by the partner country’s 2024 GDP. “Share price index change” is based on MSCI local currency indices for each country (MSCI Euro for the EU) and shows the change since the close on 2 April 2025 (note that the Chinese market was closed on 4 April 2025 and that for Taiwan was closed on 3 and 4 April 2025). \*The WTO website does not include Taiwan, so the data for the tariff imposed on the US is as published by ING in “Taiwan could avoid the worst of Trump’s reciprocal tariffs (27 March 2025)”. \*\*The tariff number quoted for the US in the “WTO tariff imposed by the US (%)” column is a weighted average of tariffs across all trading partners in 2022 as published by the World Bank. Source: IMF, ING, MSCI, Office of the US Trade Representative, US Bureau of Economic Analysis, World Bank, WTO, LSEG Datastream and Invesco Global Market Strategy Office

Analysing the short term effect of a prolonged period of the full reciprocal tariffs on the US economy involves a consideration of the impact on inflation, the reaction of the Fed to that inflation and wealth effects. Starting with the latter, **Figure 2** is a reminder that household savings rates are inversely correlated to personal wealth. Given that financial assets are around two-thirds of total US personal assets, the direction of financial markets has an important bearing on consumer spending. The drop in stocks could add to economic weakness, giving a negative feedback loop.

On the question of inflation, I assume the average tariff rate imposed by the US will increase by around 20 percentage points (the average reciprocal tariff across the largest trading partners that account for two-thirds of imports is 26%). On that basis, I think the boost to US consumer prices could be around 2% (based on an analysis by the Federal Reserve Board<sup>1</sup>). I fear that could bring a GDP hit of 1% or more and the risk of recession when wealth effects are added. It could also produce a problematic wage-price spiral. That would put the Fed in a difficult position: should it ease to accommodate the rise in inflation or should it hold rates (or even tighten) to squeeze inflation? I suspect that markets would prefer to see easing but Chairman Powell indicated on 4 April that the Fed will take its time before deciding what to do.

With the S&P 500 and NASDAQ Composite down 17% and 22%, respectively, from their 2025 peaks, is the bad news in the price? Our cyclically adjusted PE ratio (CAPE) for the Datastream US Market Index is now 35, down from a recent peak of 43 but still well above the historical average of 27 (since January 1983). Getting down to that average (seen briefly in 2020) would require a decline of 23% (equivalent to the S&P 500 falling below 4,000). Even worse, falling to the average may not be enough to persuade me that US stocks have reached bargain basement levels in the

midst of recession. A CAPE of 20 would be the equivalent of the S&P 500 falling to 2900 (and the CAPE fell to 12.2 during the GFC!).

What could prevent the market experiencing such dramatic downside? First, and foremost, rapid negotiations and/or pushback from within the US (including falling stocks and widening credit spreads) could see the minimum 10% reciprocal tariff become standard. I believe that would limit the uplift to US consumer prices to around 1% and the downside effect on US GDP to no more than 0.5%. I believe the Fed would be willing to look through that and maintain rates at current levels until sometime later this year, before recommencing the easing that started in September 2024. On that basis, I suspect that US stock indices may already have bottomed. Likewise global equities, if there is no further retaliation from other countries.

Second, interest rates have been falling across the globe, real wages are rising and leading indicators are improving. If the trade war doesn't become globalised, there may be enough momentum to leave non-US economies relatively unscathed.

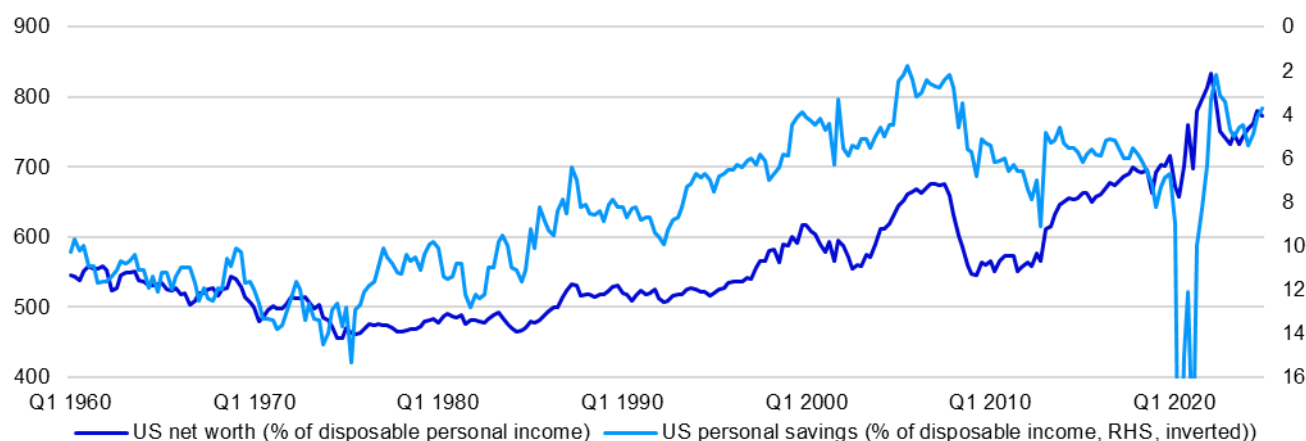
Third, without such a negotiated outcome, rapid Fed easing could stem market panic. However, the above reported comments from Chairman Powell suggest the markets would have to fall further for that happen.

Finally, the CBOE VIX volatility index reached 45 on 4 April, which has often been a good signal (on the rare occasions when the VIX has touched 45, the S&P 500 has often generated good returns over the next year).

For now, I am happy to continue Underweighting US stocks within my Model Asset Allocation (**Figure 5**).

*All data as of 4 April 2025, unless stated otherwise.*

**Figure 2 – Wealth effects could cause a rise in the savings rate and a fall in consumer spending**



Note: Quarterly data from 1960 Q1 to 2024 Q4. Net worth is for households and non-profit organisations.  
Source: LSEG Datastream and Invesco Global Market Strategy Office

## References

1. Hottman, Colin J., and Ryan Monarch (2023). "Who's Most Exposed to International Shocks? Estimating Differences in Import Price Sensitivity across U.S. Demographic Groups", International Finance Discussion Papers 1380. Washington: Board of Governors of the Federal Reserve System).

**Figure 3 – Asset class total returns (%)**

Data as at 4 Apr 2025		Current Level/RY	Total Return (USD, %)					Total Return (Local Currency, %)				
	Index		1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Equities												
World	MSCI	764	-7.9	-9.4	-7.6	-8.7	0.8	-8.1	-10.0	-7.9	-9.8	0.7
Emerging Markets	MSCI	1088	-2.9	-0.1	-1.2	1.8	6.7	-3.0	-0.6	-1.3	1.4	9.6
China	MSCI	73	-3.0	0.1	-1.5	13.3	37.2	-3.0	0.2	-1.5	13.3	36.6
US	MSCI	4833	-9.1	-12.3	-9.6	-13.7	-0.2	-9.1	-12.3	-9.6	-13.7	-0.2
Europe	MSCI	2081	-6.9	-5.7	-5.4	4.7	1.5	-8.0	-9.1	-6.7	-0.8	-0.6
Europe ex-UK	MSCI	2572	-6.9	-5.7	-5.2	5.1	-0.1	-8.4	-9.5	-6.9	-1.0	-2.2
UK	MSCI	1243	-6.9	-5.7	-5.8	3.3	7.1	-6.8	-7.4	-6.1	0.0	4.9
Japan	MSCI	3745	-7.4	-6.3	-4.2	-3.7	-4.5	-10.3	-8.1	-6.7	-10.8	-8.3
Government Bonds												
World	BofA-ML	3.12	2.5	2.5	2.3	5.3	4.2	1.5	0.9	1.3	2.1	3.4
Emerging Markets	BBloom	7.04	-0.8	-2.1	-0.9	1.9	9.3	-0.8	-2.1	-0.9	1.9	9.3
China	BofA-ML	1.68	0.2	-0.2	0.0	-0.1	5.6	0.7	0.1	0.8	0.0	6.6
US (10y)	Datastream	4.02	2.0	1.9	1.6	5.7	6.7	2.0	1.9	1.6	5.7	6.7
Europe	Bofa-ML	2.75	2.4	4.0	2.6	5.8	3.6	0.9	-0.3	0.9	-0.3	2.5
Europe ex-UK (EMU, 10y)	Datastream	2.54	2.9	3.9	3.1	5.1	2.0	1.4	-0.4	1.3	-1.0	0.9
UK (10y)	Datastream	4.45	2.1	2.9	2.2	5.8	3.6	2.1	1.1	1.9	2.4	1.4
Japan (10y)	Datastream	1.15	6.9	4.5	5.8	7.9	2.5	3.5	2.5	3.0	-0.1	-1.7
IG Corporate Bonds												
Global	BofA-ML	4.62	0.7	1.0	0.6	3.5	5.7	0.3	-0.2	0.1	1.8	5.5
Emerging Markets	BBloom	6.59	-0.6	-0.6	-0.7	3.3	11.1	-0.6	-0.6	-0.7	3.3	11.1
China	BofA-ML	2.39	-0.1	-0.2	-0.3	0.1	3.8	0.4	0.1	0.4	0.2	4.7
US	BofA-ML	5.18	0.3	-0.1	0.1	2.5	5.9	0.3	-0.1	0.1	2.5	5.9
Europe	BofA-ML	3.33	1.5	3.6	1.7	6.3	5.5	0.0	-0.7	0.0	0.2	4.3
UK	BofA-ML	5.58	0.6	1.2	0.7	4.4	5.5	0.6	-0.5	0.5	1.0	3.3
Japan	BofA-ML	1.25	4.7	3.0	4.0	8.3	4.0	1.4	1.1	1.2	0.3	-0.2
HY Corporate Bonds												
Global	BofA-ML	8.04	-1.4	-1.6	-1.3	0.6	6.7	-1.7	-2.4	-1.6	-0.5	6.5
US	BofA-ML	8.46	-2.0	-2.8	-2.0	-1.0	5.9	-2.0	-2.8	-2.0	-1.0	5.9
Europe	BofA-ML	6.33	0.4	2.4	0.8	5.8	7.7	-1.1	-1.9	-0.9	-0.3	6.5
Cash (Overnight LIBOR)												
US		4.36	0.1	0.3	1.1	1.1	5.0	0.1	0.3	1.1	1.1	5.0
Euro Area		2.42	0.2	4.6	5.3	5.3	3.8	0.0	0.2	0.7	0.7	3.4
UK		4.46	0.3	3.2	4.6	4.6	7.7	0.1	0.3	1.1	1.1	5.0
Japan		0.48	-0.3	0.6	5.0	5.0	1.3	0.0	0.0	0.1	0.1	0.2
Real Estate (REITs)												
Global	FTSE	1526	-4.8	-6.5	-4.8	-3.3	2.3	-6.2	-10.4	-6.5	-8.8	1.2
Emerging Markets	FTSE	1146	-1.5	-1.1	-1.1	-1.8	-0.8	-3.0	-5.3	-2.8	-7.5	-1.9
US	FTSE	2934	-6.9	-10.4	-7.8	-6.9	4.9	-6.9	-10.4	-7.8	-6.9	4.9
Europe ex-UK	FTSE	2365	-0.2	-1.0	0.5	3.0	3.7	-1.7	-5.1	-1.2	-2.9	2.5
UK	FTSE	795	-3.8	1.2	-2.8	2.2	-6.8	-3.8	-0.5	-3.0	-1.0	-8.8
Japan	FTSE	2180	0.1	4.5	2.3	14.1	1.4	-3.0	2.5	-0.4	5.7	-2.7
Commodities												
All	GSCI	3530	-6.7	-4.6	-7.9	-3.4	-7.2	-	-	-	-	-
Energy	GSCI	590	-9.2	-7.8	-11.6	-7.3	-15.4	-	-	-	-	-
Industrial Metals	GSCI	1593	-8.8	-7.3	-8.0	-3.2	-5.8	-	-	-	-	-
Precious Metals	GSCI	3297	-3.6	2.3	-4.6	12.9	28.1	-	-	-	-	-
Agricultural Goods	GSCI	504	-0.6	-0.1	-0.9	-2.1	-1.8	-	-	-	-	-
Currencies (vs USD)*												
EUR		1.10	1.2	3.1	1.3	5.8	1.1	-	-	-	-	-
JPY		146.92	2.0	2.0	2.1	7.0	3.0	-	-	-	-	-
GBP		1.29	0.0	1.8	0.2	3.3	2.1	-	-	-	-	-
CHF		1.16	2.3	3.4	2.8	5.4	4.7	-	-	-	-	-
CNY		7.28	-0.3	-0.2	-0.3	0.2	-0.7	-	-	-	-	-

Notes: **Past performance is no guarantee of future results.** \*The currency section is organised so that in all cases the numbers show the movement in the mentioned currency versus USD (+ve indicates appreciation, -ve indicates depreciation). Please see appendix for definitions, methodology and disclaimers.

Source: LSEG Datastream and Invesco Global Market Strategy Office

**Figure 4 – Global equity sector total returns relative to market (%)**

Data as of 04 Apr 2025	Global				
	1w	1m	QTD	YTD	12m
<b>Energy</b>	<b>-0.9</b>	<b>5.6</b>	<b>-1.5</b>	<b>3.6</b>	<b>-10.4</b>
<b>Basic Materials</b>	<b>-0.9</b>	<b>3.8</b>	<b>-0.2</b>	<b>5.7</b>	<b>-12.1</b>
Basic Resources	-3.0	4.0	-1.9	5.9	-11.1
Chemicals	2.2	3.4	2.4	5.3	-13.5
<b>Industrials</b>	<b>-0.9</b>	<b>0.2</b>	<b>-0.7</b>	<b>0.8</b>	<b>-2.8</b>
Construction & Materials	1.8	5.8	2.5	3.7	-2.8
Industrial Goods & Services	-1.3	-0.6	-1.2	0.4	-2.8
<b>Consumer Discretionary</b>	<b>0.5</b>	<b>-2.2</b>	<b>0.8</b>	<b>-4.1</b>	<b>-1.5</b>
Automobiles & Parts	-0.4	0.0	1.0	-16.4	-7.5
Media	-1.4	-3.5	-1.4	-0.3	5.9
Retailers	1.3	-2.4	0.6	-3.1	5.8
Travel & Leisure	-0.2	-4.3	-0.1	-4.5	-3.1
Consumer Products & Services	1.1	-1.8	2.2	3.7	-9.1
<b>Consumer Staples</b>	<b>6.5</b>	<b>9.5</b>	<b>5.8</b>	<b>14.8</b>	<b>5.6</b>
Food, Beverage & Tobacco	6.3	9.6	5.6	15.7	4.5
Personal Care, Drug & Grocery Stores	6.8	9.3	6.0	13.4	7.7
<b>Healthcare</b>	<b>1.1</b>	<b>-0.4</b>	<b>0.8</b>	<b>5.3</b>	<b>-4.2</b>
<b>Financials</b>	<b>-0.6</b>	<b>2.4</b>	<b>-0.6</b>	<b>6.7</b>	<b>11.1</b>
Banks	-0.8	2.1	-0.7	7.8	12.4
Financial Services	-1.4	0.3	-1.6	1.7	6.5
Insurance	1.4	6.7	1.3	13.5	16.3
<b>Real Estate</b>	<b>3.8</b>	<b>4.0</b>	<b>3.4</b>	<b>6.9</b>	<b>3.6</b>
<b>Technology</b>	<b>-2.8</b>	<b>-7.2</b>	<b>-2.5</b>	<b>-12.5</b>	<b>-2.8</b>
<b>Telecommunications</b>	<b>3.3</b>	<b>6.6</b>	<b>3.3</b>	<b>13.0</b>	<b>13.0</b>
<b>Utilities</b>	<b>5.1</b>	<b>10.5</b>	<b>4.5</b>	<b>10.2</b>	<b>9.9</b>

Notes: **Past performance is no guarantee of future results.** Returns shown are for Datastream sector indices versus the total market index. Source: LSEG Datastream and Invesco Global Market Strategy Office

**Figure 5 – Model asset allocation**

	Neutral	Policy Range	Allocation	Position vs Neutral	Hedged	Currency
<b>Cash Equivalents</b>	<b>5%</b>	<b>0-10%</b>	<b>0%</b>			
Cash	2.5%		0%			
Gold	2.5%		0%			
<b>Bonds</b>	<b>40%</b>	<b>10-70%</b>	<b>35%</b>			
Government	25%	10-40%	21%			
US	8%		6%		50% JPY	
Europe ex-UK (Eurozone)	7%		7%			
UK	1%		2%			
Japan	7%		2%			
Emerging Markets	2%		4%			
China**	0.2%		0%			
Corporate IG	10%	0-20%	10%			
US Dollar	5%		5%		50% JPY	
Euro	2%		1%			
Sterling	1%		2%			
Japanese Yen	1%		0%			
Emerging Markets	1%		2%			
China**	0.1%		0%			
Corporate HY	5%	0-10%	4%			
US Dollar	4%		3%		50% JPY	
Euro	1%		1%			
<b>Bank Loans</b>	<b>4%</b>	<b>0-8%</b>	<b>8%</b>			
US	3%		6%			
Europe	1%		2%			
<b>Equities</b>	<b>45%</b>	<b>25-65%</b>	<b>45%</b>			
US	25%		12%			
Europe ex-UK	7%		12%			
UK	4%		6%			
Japan	4%		5%			
Emerging Markets	5%		10%			
China**	2%		4%			
<b>Real Estate</b>	<b>4%</b>	<b>0-8%</b>	<b>8%</b>			
US	1%		1%			
Europe ex-UK	1%		2%			
UK	1%		2%			
Japan	1%		2%			
Emerging Markets	1%		1%			
<b>Commodities</b>	<b>2%</b>	<b>0-4%</b>	<b>4%</b>			
Energy	1%		2%			
Industrial Metals	0.3%		1%			
Precious Metals	0.3%		0%			
Agriculture	0.3%		1%			
<b>Total</b>	<b>100%</b>		<b>100%</b>			
<b>Currency Exposure (including effect of hedging)</b>						
USD	52%		30%			
EUR	19%		25%			
GBP	7%		12%			
JPY	13%		16%			
EM	9%		17%			
<b>Total</b>	<b>100%</b>		<b>100%</b>			

Notes: \*\*China is included in Emerging Markets allocations. This is a theoretical portfolio and is for illustrative purposes only. See the latest [The Big Picture](#) document for more details. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. Arrows indicate the direction of the most recent changes.

Source: Invesco Global Market Strategy Office

**Figure 6 – Model allocations for global sectors**

	<b>Neutral</b>	<b>Invesco</b>	<b>Preferred Region</b>
<b>Energy</b>	<b>6.1%</b>	<b>Overweight</b> ↑	<b>EM</b>
<b>Basic Materials</b>	<b>3.3%</b>	<b>Neutral</b> ↑	<b>Japan</b>
Basic Resources	2.0%	Neutral ↑	Japan
Chemicals	1.3%	Neutral	US
<b>Industrials</b>	<b>12.9%</b>	<b>Underweight</b>	<b>US</b>
Construction & Materials	1.7%	Underweight	US
Industrial Goods & Services	11.2%	Neutral ↑	US
<b>Consumer Discretionary</b>	<b>14.8%</b>	<b>Underweight</b>	<b>US</b>
Automobiles & Parts	2.8%	Underweight	Europe
Media	1.2%	Overweight ↑	US
Retailers	5.6%	Overweight	US
Travel & Leisure	2.0%	Underweight	EM
Consumer Products & Services	3.1%	Underweight	Japan
<b>Consumer Staples</b>	<b>4.9%</b>	<b>Neutral</b> ↓	<b>US</b>
Food, Beverage & Tobacco	3.1%	Overweight	US
Personal Care, Drug & Grocery Stores	1.8%	Neutral ↓	Europe
<b>Healthcare</b>	<b>8.4%</b>	<b>Underweight</b> ↓	<b>US</b>
<b>Financials</b>	<b>16.1%</b>	<b>Overweight</b>	<b>US</b>
Banks	7.6%	Overweight	US
Financial Services	5.5%	Overweight	US
Insurance	3.0%	Neutral ↓	US
<b>Real Estate</b>	<b>2.6%</b>	<b>Neutral</b>	<b>Japan</b>
<b>Technology</b>	<b>24.4%</b>	<b>Neutral</b>	<b>EM</b>
<b>Telecommunications</b>	<b>3.3%</b>	<b>Underweight</b>	<b>US</b>
<b>Utilities</b>	<b>3.2%</b>	<b>Underweight</b> ↓	<b>US</b>

Notes: These are theoretical allocations which are for illustrative purposes only. They do not represent an actual portfolio and are not a recommendation of any investment or trading strategy. See the latest [Strategic Sector Selector](#) for more details.

Source: LSEG Datastream and Invesco Global Market Strategy Office

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## Appendix

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### Methodology for asset allocation, expected returns and optimal portfolios

#### Which asset classes?

We look for investibility, size and liquidity. We have chosen to include equities, bonds (government, corporate investment grade and corporate high yield), bank loans, REITs to represent real estate, commodities and cash (all across a range of geographies). We use cross-asset correlations to determine which decisions are the most important.

#### Neutral allocations and policy ranges

We use market capitalisation in USD for major benchmark indices to calculate neutral allocations. For commodities, we use industry estimates for total ETP market cap + assets under management in hedge funds + direct investments. We use an arbitrary 5% for the combination of cash and gold. We impose diversification by using policy ranges for each asset category (the range is usually symmetric around neutral).

#### Expected/projected returns

The process for estimating expected returns is based upon yield (except commodities, of course). After analysing how yields vary with the economic cycle, and where they are situated within historical ranges, we forecast the direction and amplitude of moves over the next year. Cash returns are calculated assuming a straight-line move in short term rates towards our targets (with, of course, no capital gain or loss). Bond returns assume a straight-line progression in yields, with capital gains/losses predicated upon constant maturity (effectively supposing constant turnover to achieve that). Forecasts of corporate investment-grade, high-yield and bank loan spreads are based upon our view of the economic cycle (as are forecasts of credit losses). Coupon/interest payments are added to give total returns. Equity and REIT returns are based on dividend growth assumptions. We calculate total returns by applying those growth assumptions and adding the forecast dividend yield. No such metrics exist for commodities; therefore, we base our projections on US CPI-adjusted real prices relative to their long-term averages and views on the economic cycle. All expected returns are calculated in local currency and then, where necessary, converted into other currency bases using our exchange rate forecasts.

#### Currency hedging

We adopt a cautious approach when it comes to currency hedging as currency movements are notoriously difficult to accurately predict and sometimes hedging can be costly. Also, some of our asset allocation choices are based on currency forecasts. We use an amalgam of central bank rate forecasts, policy expectations and real exchange rates relative to their historical averages to predict the direction and amplitude of currency moves.

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**Definitions of data and benchmarks for Figure 3**

**Sources:** we source data from LSEG Datastream unless otherwise indicated.

**Cash:** returns are based on a proprietary index calculated using the Intercontinental Exchange Benchmark Administration overnight LIBOR (London Interbank Offer Rate). From 1<sup>st</sup> January 2022, we use the Refinitiv overnight deposit rate for the euro, the British pound and the Japanese yen. The global rate is the average of the euro, British pound, US dollar and Japanese yen rates. The series started on 1 January 2001 with a value of 100.

**Gold:** London bullion market spot price in USD/troy ounce.

**Government bonds:** Current levels, yields and total returns use Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK, and the ICE BofA government bond total return index for the World and Europe. The emerging markets yields and returns are based on the Bloomberg emerging markets sovereign US dollar bond index.

**Corporate investment grade (IG) bonds:** ICE BofA investment grade corporate bond total return indices, except for in emerging markets where we use the Bloomberg emerging markets corporate US dollar bond index.

**Corporate high yield (HY) bonds:** ICE BofA high yield total return indices

**Equities:** We use MSCI benchmark gross total return indices for all regions.

**Commodities:** Goldman Sachs Commodity total return indices

**Real estate:** FTSE EPRA/NAREIT total return indices

**Currencies:** Global Trade Information Services spot rates

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**Investment risks**

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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