Asset Allocation Survey

15th September 2022

Asset Allocators Remain Defensive

But September's Poll is no Worse than June's

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Fundamental Challenges Still Lie Ahead for Risk Assets

Despite high probabilities of a Global Recession (62%), a higher US unemployment rate (76%), and tighter Global monetary conditions (71%), together with Earnings pressures, asset allocators still place a 55% probability on Stocks beating Bonds.

House Prices Unlikely to be Higher in 12m Time Say Asset Allocators

The tightening of Global monetary conditions is starting to impact housing. Asset allocators put the probability of higher home prices as low as 32%. A third of the panel thought it '<u>very unlikely</u>' that house prices would be higher in 12mths time.

Differing Views of Recovery Divide the Panel into Bulls and Bears

The key division between the two, almost equally sized, groups in the panel is all about whether the Global economy can recover and risk assets rally next year. It might be a cliché, but the labels of 'Bulls' and 'Bears' are for once appropriate.

RELATED RESEARCH:

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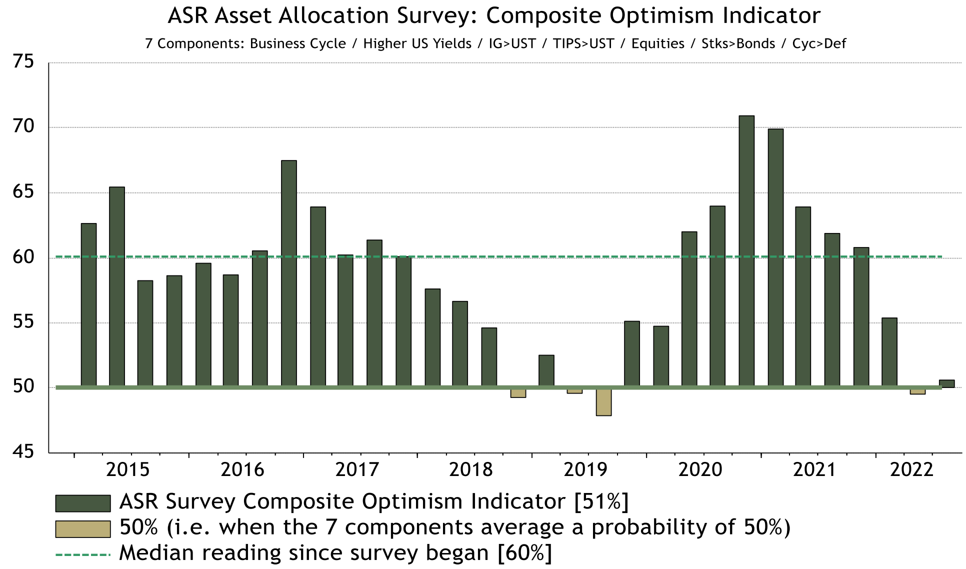
Key chart: ASR's "Composite Optimism Indicator" Remains Depressed



Source: ASR Ltd.
Based on 245 respondents managing over $4.8trn AUM (Fieldwork: 25th Aug - 8th Sept 2022)

Asset Allocators Remain Defensive

*ASR's Asset Allocation Survey is a survey of probabilities. Every quarter we ask CIOs, asset allocators, economists, and multi-asset strategists about the outlook for financial markets for the next 12 months. However, instead of asking them about how they are positioned, we try to map how they see the prospects for financial markets in terms of probabilities. The fieldwork took place between 25th August and 8th September, with **245 responses**, overseeing **$4.8trillion** of AUM.*

Highlights from the Survey: What has Changed…

What is striking about this survey is not how much has changed, but how little

Asset allocators still hawkish on monetary policy, but less so than three months' ago

Preference for 'Value' squeezed by earnings prospects

Less confident about real assets

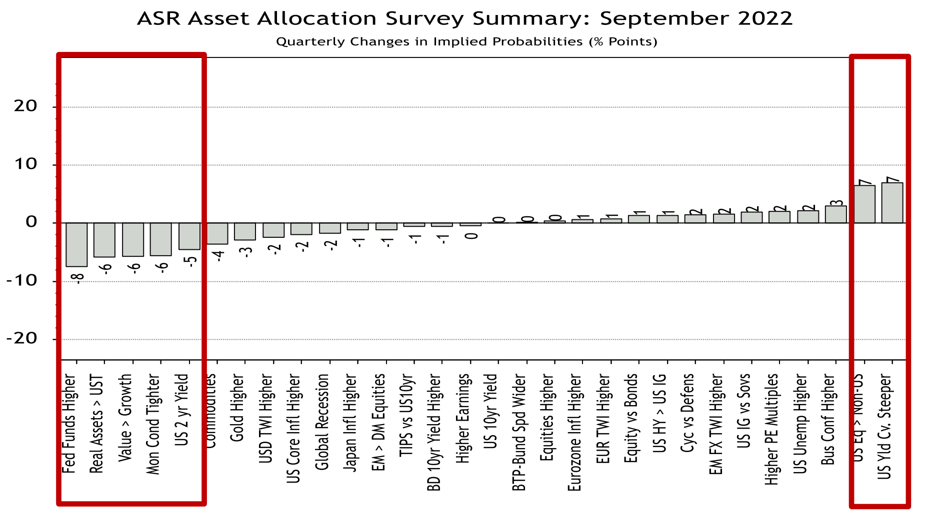
What is immediately striking about our latest survey is not how much has changed but how little. Just look at chart AAS 1 and you can see that of all the questions tracked, only seven have seen their implied probabilities move by plus/minus 5 percentage points (our threshold for a 'material' change). Those seven questions can be condensed into three elements: (1) asset allocators have become slightly less hawkish about monetary policy and interest rates than three months ago – and are more confident the US yield curve will be more positively sloped a year from now; (2) they have trimmed their preference for Value and implicitly added to their preference for US Equities over 'International'; and (3) they have become less confident about Real Assets – reflecting softer commodity prices and concerns about residential real estate.

Part of reason for the inertia is that markets have done relatively little over the past three months

To some extent, this inertia can be partly explained by the fact that market levels are not that different from three months ago. Global Equities, US High-Yield and Investment-Grade Credit, as well as many Sovereign Bond markets were broadly unchanged between the two fieldwork periods, although the US S&P was up 6%. The bigger changes were concentrated in Commodities (Brent down 19% / Gold down 6%) and in FX (with the DXY index up 5%).

There were very few material changes (greater than +/- 5% points) in probabilities this quarter

AAS. 1: How Probabilities have Changed since the Previous Survey



Source: ASR Ltd.

But what is not in doubt is that this is still a 'bearish' wave

However, what is not in doubt is that this is still a bearish 'wave'. Our Composite Optimism Indicator (see front-page chart) recorded the fifth weakest reading in the survey's history. Investor conviction (based on ten core questions that we have tracked throughout the survey's history) hit an all-time low (typically a bearish signal). The probability that Stocks would beat Bonds stood at 55% (the second weakest recorded) while the probability that Global Equities would be higher a year from now was the fourth lowest on record. Investors remain downbeat about the chances of seeing higher Global corporate earnings (with a record low probability of 37%). In fact, 36% of respondents thought neither corporate earnings nor valuations would be higher a year from now.

There is still something of a disconnect between respondents' macro assumptions and the read-through to financial markets

But although this is a bearish survey, there still seems to be something of a disconnect between respondents' macro assumptions and the read-through to financial markets. Investors expect the world to be in recession a year from now (probability 62%); the US unemployment rate to be higher (probability 76%); and Global monetary conditions to be tighter (probability 71%). These parameters do not spell soft landing. Instead, they point to a world of increasingly negative output gaps, where pricing power comes under downward pressure, where corporate earnings get undermined, and where US corporate Credit spreads widen as the old Credit cycle dies and a new default cycle gets underway.

We worry that the Survey may not be capturing the scale of the Credit and Liquidity risks embedded in those macro assumptions

There is complacency about IG Credit's ability to outperform in a recession

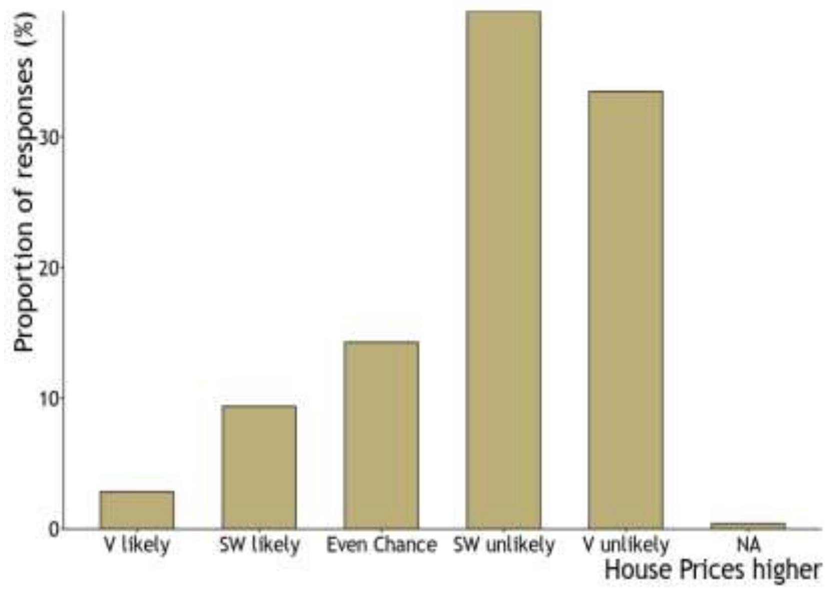
We worry that the Survey may not be capturing the scale of the Credit and Liquidity risks embedded in those macro assumptions. For example, investors are already wary of HY and EM Bonds, but continue to believe that Investment Grade (IG) will outperform US Treasuries (UST) despite the macro backdrop. 21% of the panel expect IG>UST even as they think a recession is likely, while 33% expect IG>UST even if the US unemployment rate moves higher. IG paper cannot afford to disappoint.

Respondents are very gloomy about the outlook for house prices in the region where they live

However, one area where the policy tightening is starting to bite is in residential real estate. In a new question this quarter, we asked asset allocators how likely they thought it would be that house prices (where they lived) would be higher a year from now. The implied probability was an astonishingly low 32%. A third of the panel thought it would be 'very unlikely' that house prices would be higher in 12 months' time. This is an aggressive call and suggests the tightening of monetary conditions is starting to impact an important source of collateral.

A third of the panel thinks it is "very unlikely" that house prices will be higher a year from now

AAS. 2: A New Question - Will House Prices be Higher a Year from Now?



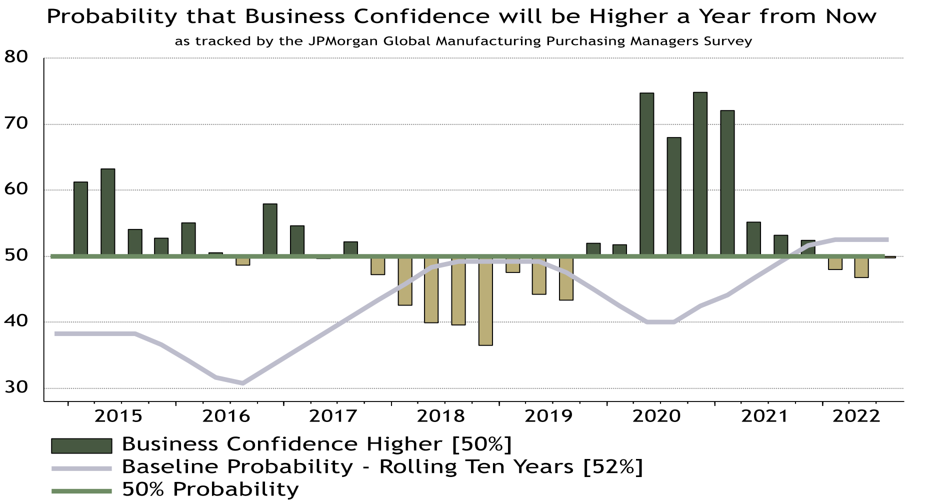
Source: ASR Ltd

Macro Assumptions

Our panel is ambivalent about whether the Global business cycle will be stronger or weaker a year from now …

… but this 50% probability hides a bimodal distribution that makes this a defining question for our 'tribes' (P14-15)

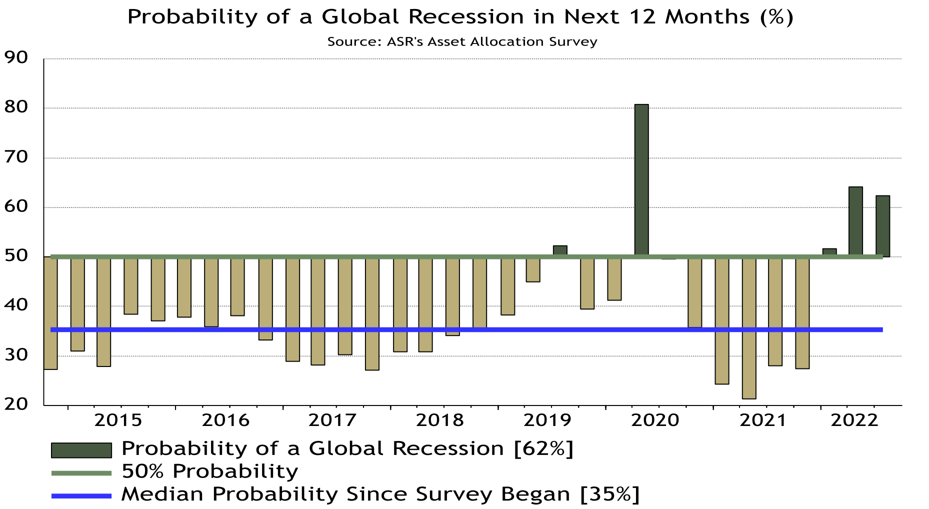
AAS. 3: Probability of Higher Business Confidence a Year from Now



Source: ASR Ltd. / Refinitiv Datastream

But they are more convinced that the Global economy will be in recession …

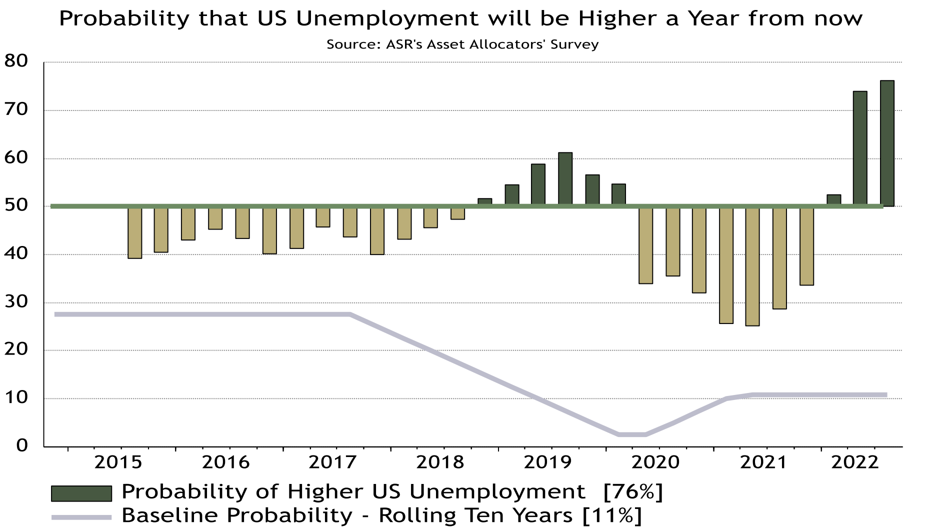
AAS. 4: Probability of a Global Recession in the Next 12 Months



Source: ASR Ltd. / Refinitiv Datastream

… and very confident that the US unemployment rate will be higher

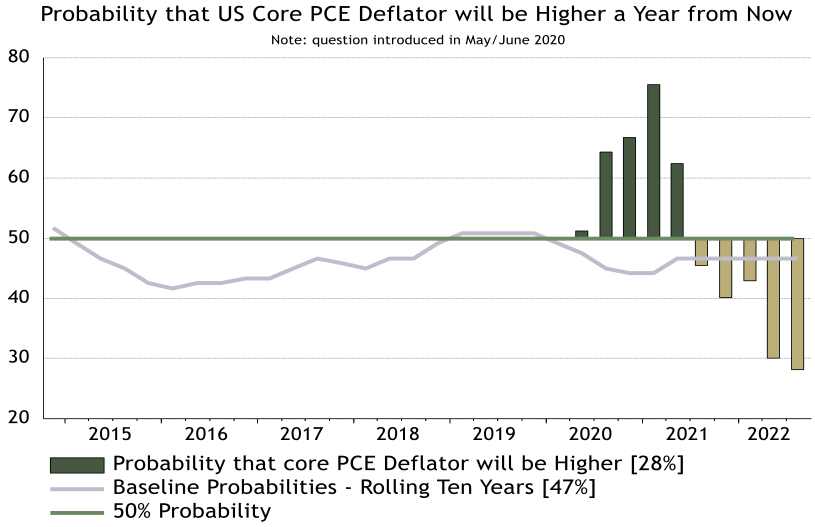
AAS. 5: Probability of Higher US Unemployment Rate in 12m Time



Source: ASR Ltd. / Refinitiv Datastream

AAS. 6: Probability that US Core PCE Deflator will be Higher

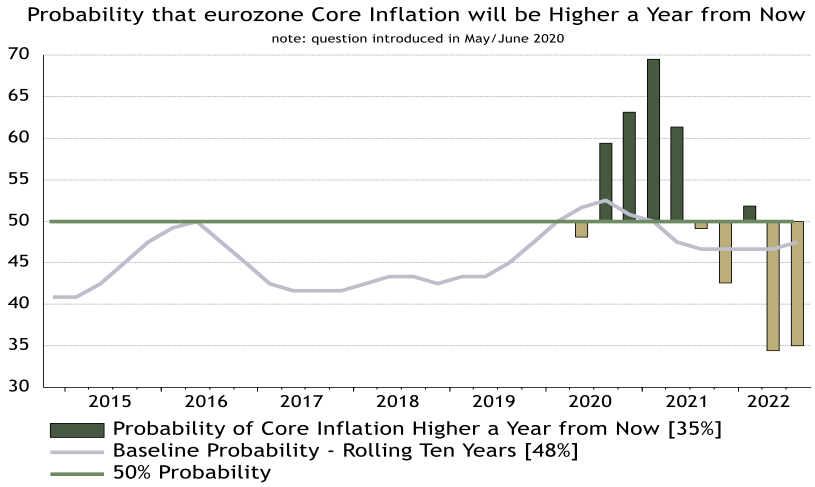
Investors think it is extremely unlikely that US core PCE inflation will be higher a year from now



Source: ASR Ltd. / Refinitiv Datastream

AAS. 7: Probability that eurozone Core CPI will be Higher

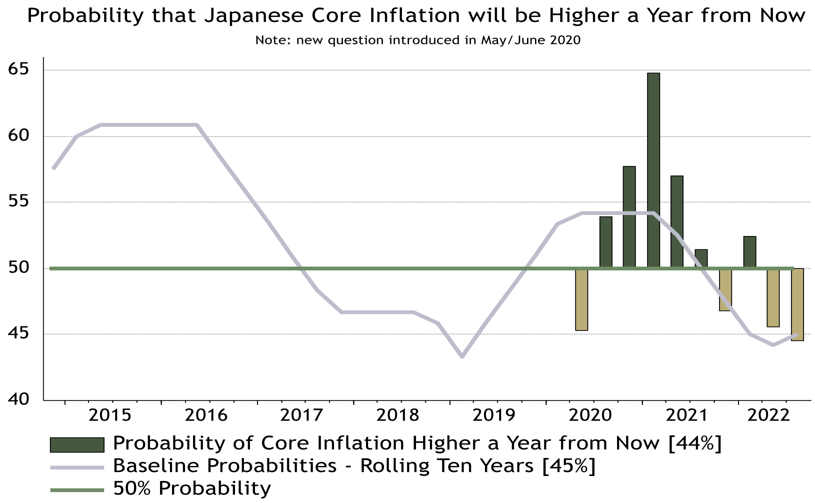
The same is true in the eurozone for core CPI inflation



Source: ASR Ltd. / Refinitiv Datastream

AAS. 8: Probability that Japanese Core CPI will be Higher

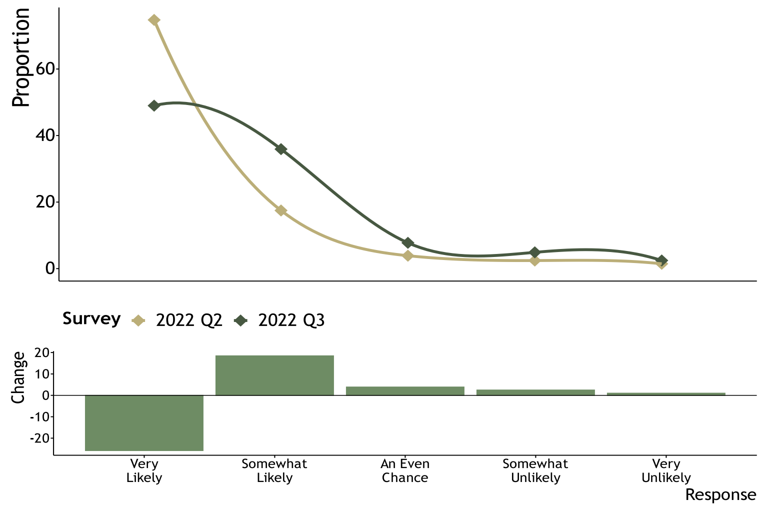
... less so in Japan where core inflation has been less elevated



Source: ASR Ltd. / Refinitiv Datastream

Investors are still placing a 75% probability on Fed Funds being higher a year from now … although we were surprised to see the "very likely" percentage drop away quite so sharply

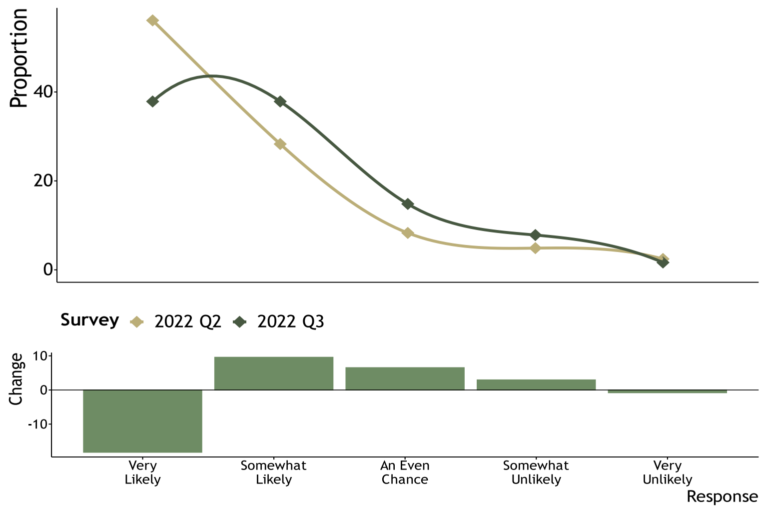
AAS. 9: Probability that US Federal Funds Rate will be Higher



Source: ASR Ltd.

There was a 71% probability that Global monetary conditions would be tighter a year from now

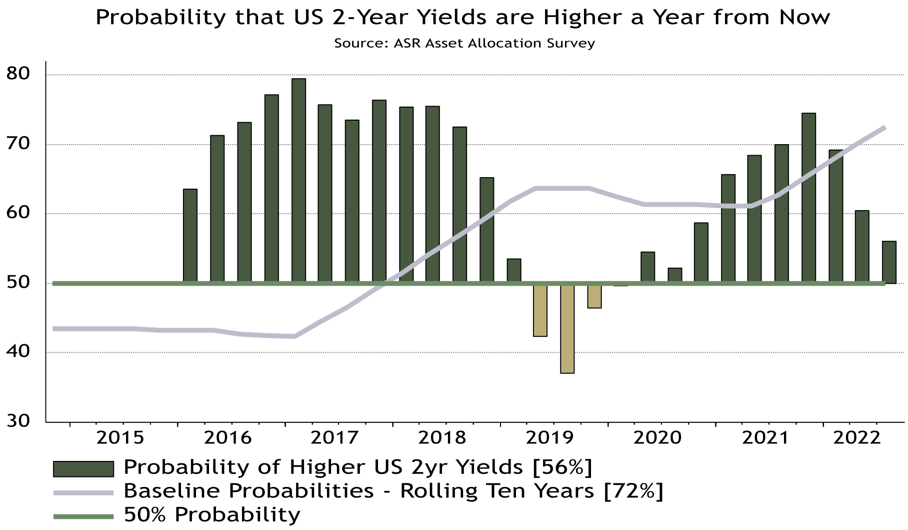
AAS. 10: Probability that Global Monetary Conditions Tighter



Source: ASR Ltd.

The probability that US 2yr Treasury yields will be higher a year from now dropped for the third quarter running to 56%

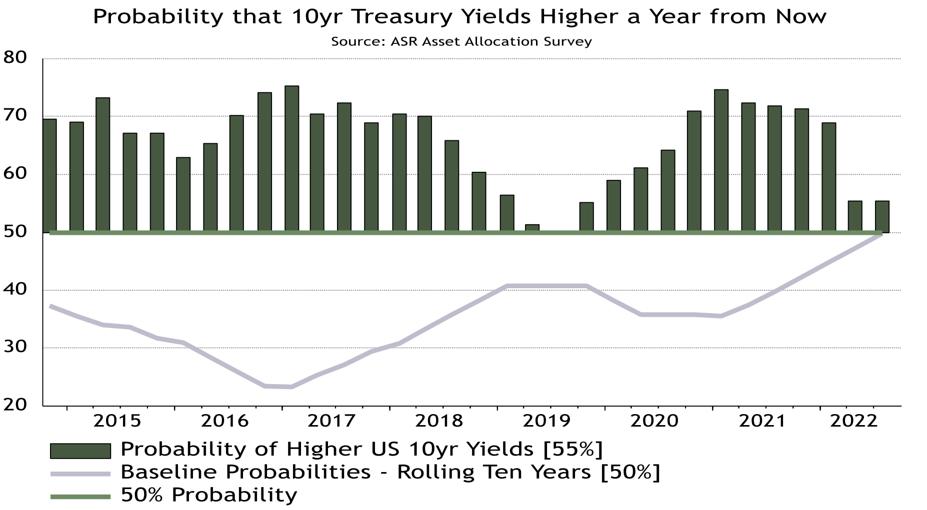
AAS.11: Probability of Higher 2yr Treasury Yields a Year from Now



Source: ASR Ltd. / Refinitiv Datastream

For the second quarter running, investors have placed a relatively low probability on 10yr UST yields being higher a year from now, suggesting that they may be seeing some value at current levels

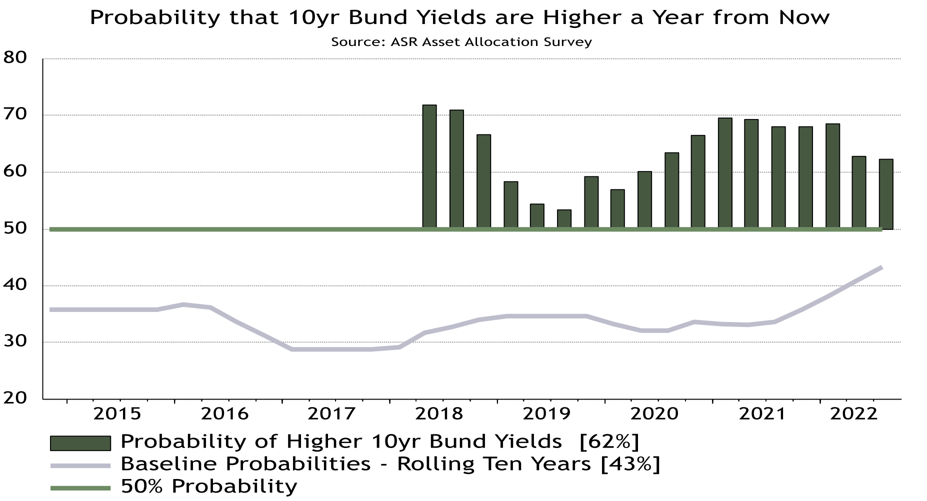
AAS. 12: Probability of Higher 10yr UST Yields a Year from Now



Source: ASR Ltd. / Refinitiv Datastream

Investors have more concerns that Bund yields may yet go higher

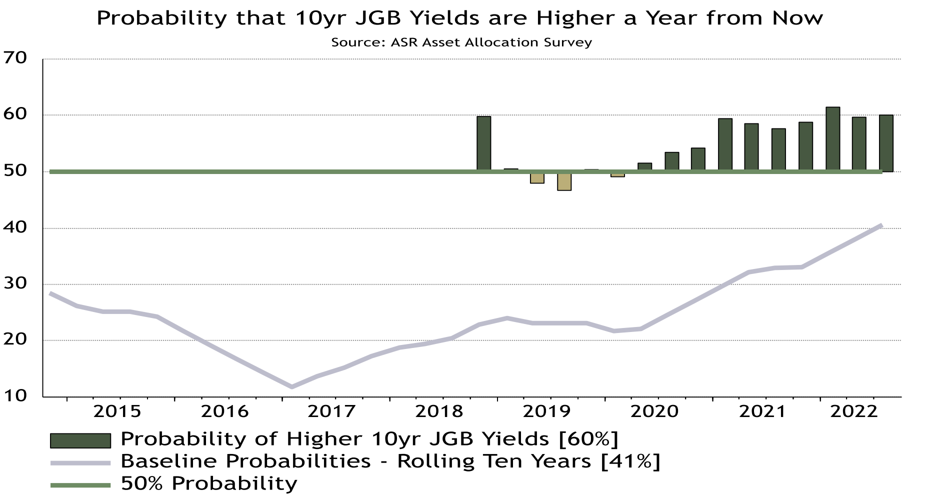
AAS. 13: Probability of Higher10yr Bund Yields a Year from Now



Source: ASR Ltd. / Refinitiv Datastream

The probability that JGB yields may move higher remains high at around 60% - perhaps in anticipation of a change of BoJ's QQE policy stance

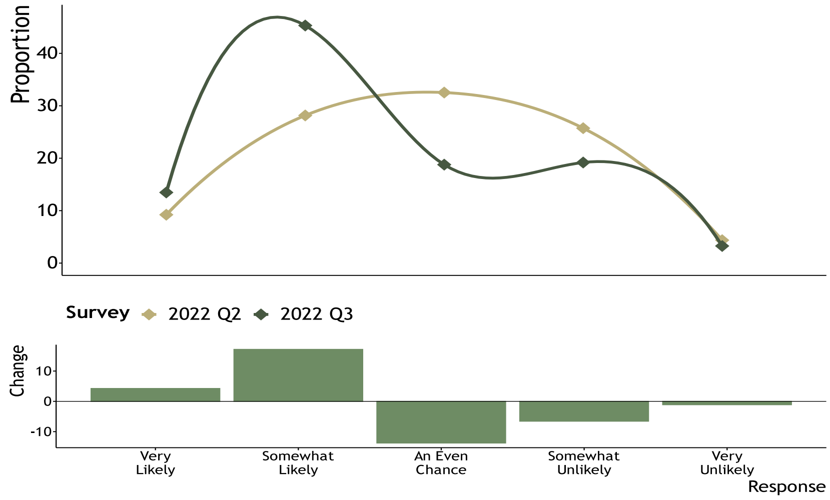
AAS. 14: Probability of Higher10yr JGB Yields a Year from Now



Source: ASR Ltd. / Refinitiv Datastream

AAS.15: Probability that US Yield Curve will be Steeper

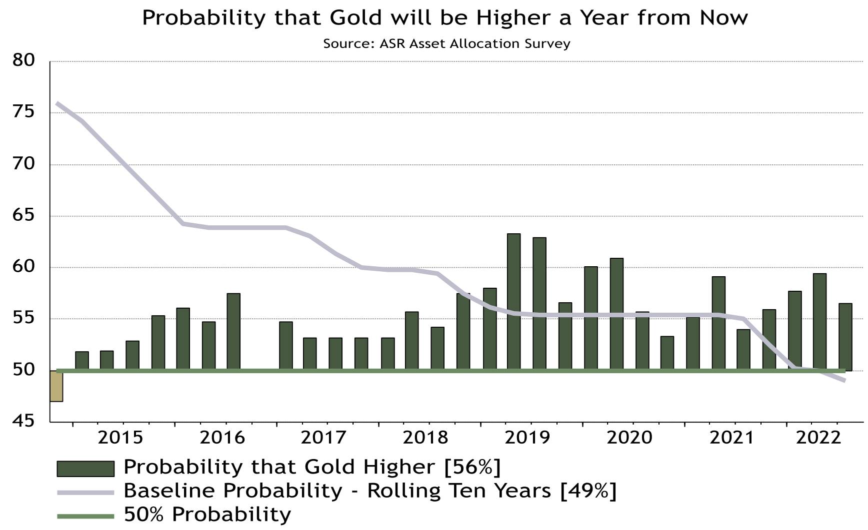
There has been a pick-up in the probability of a steeper, more positive, US yield curve from 52% to 59%. This is consistent with investors' expectations of higher unemployment and lower core inflation



Source: ASR Ltd.

AAS.16: Probability that Gold will be Higher a Year from Now

Gold fell 6% between the June 2022 and September 2022 fieldworks – which may explain why the enthusiasm for the precious metal has waned slightly

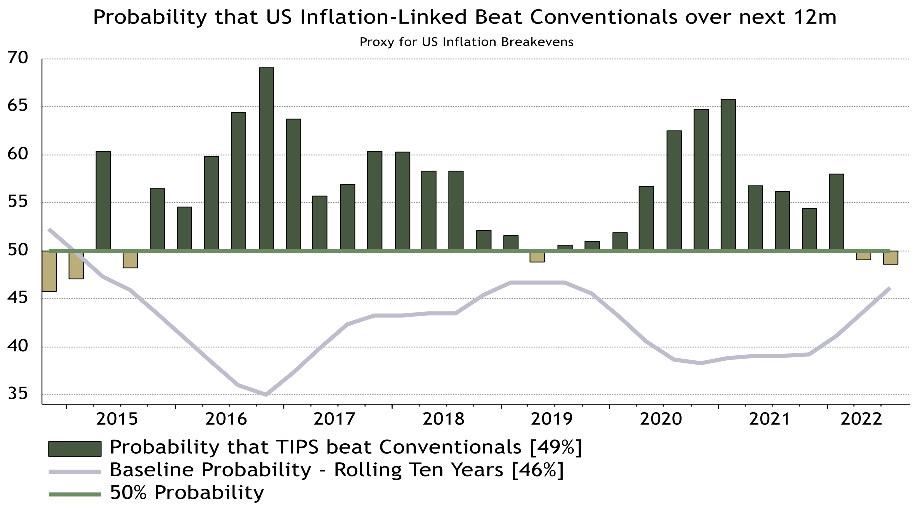


Source: ASR Ltd. / Refinitiv Datastream

AAS.17: Probability that US TIPS Will Beat Conventionals

For the second quarter running, asset allocators think that inflation-linked TIPS are unlikely to outperform Conventionals …

… this would be consistent with a decline in inflation and a drop-off in pricing power

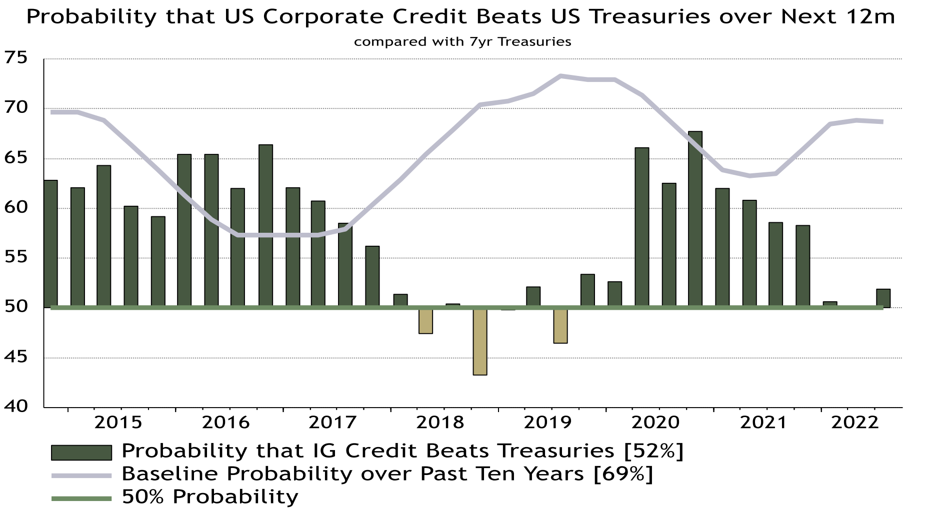


Source: ASR Ltd. / Refinitiv Datastream

So this is interesting …

… there's a recession coming; US unemployment is expected to rise; and earnings are forecast to come under pressure. Yet investors still expect US Investment-Grade Credit to outperform US Treasuries

AAS.18: Probability that US IG Credit will Beat Treasuries

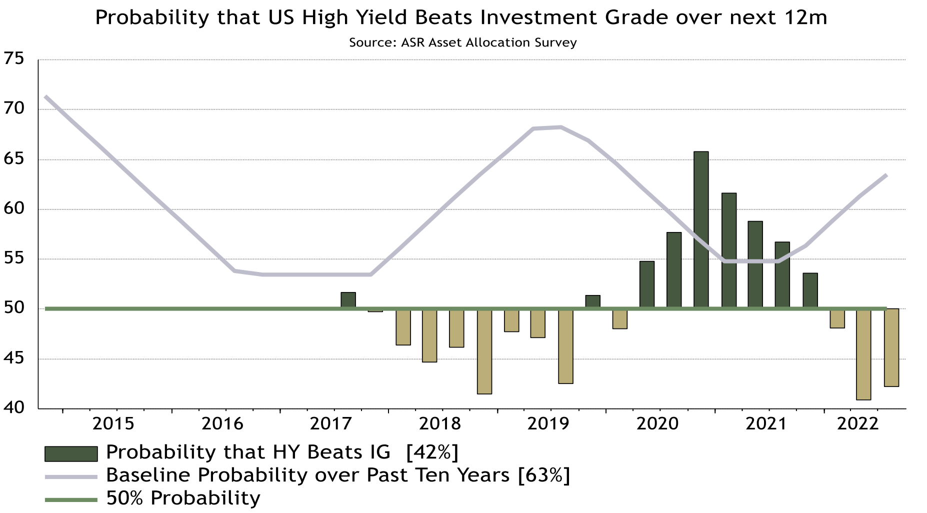


Source: ASR Ltd. / Refinitiv Datastream

Contrast that with US High Yield …

… asset allocators already expect HY to underperform its Investment Grade peers, consistent with concerns over Credit quality

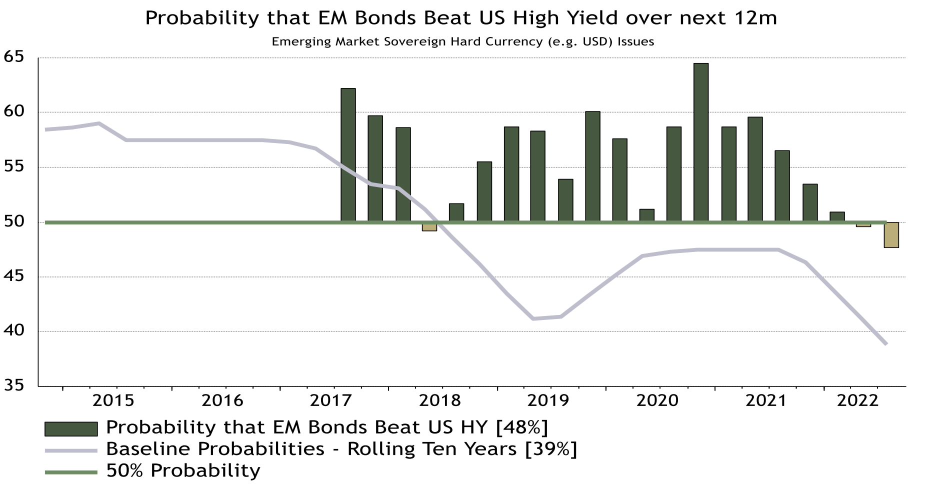
AAS.19: Probability that US HY Credit will Beat US IG Credit



Source: ASR Ltd. / Refinitiv Datastream

For only the third time in the survey's history, investors now prefer US High Yield Credit over EM Sovereign Hard-Currency Bonds

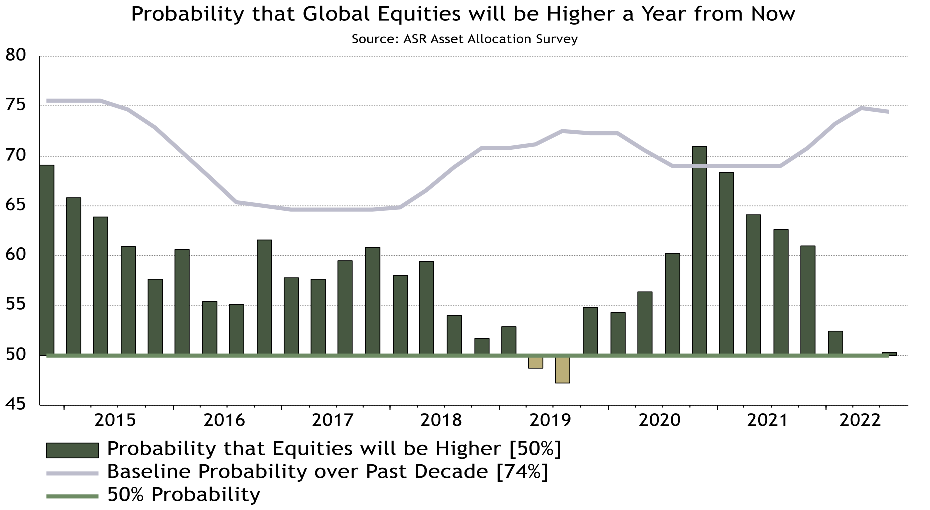
AAS.20: Probability that EM Bonds will Beat US High-Yield Credit



Source: ASR Ltd. / Refinitiv Datastream

AAS.21: Probability that Global Equities will be Higher in 12m Time

Little optimism that Global Equities will be higher a year from now …



Source: ASR Ltd. / Refinitiv Datastream

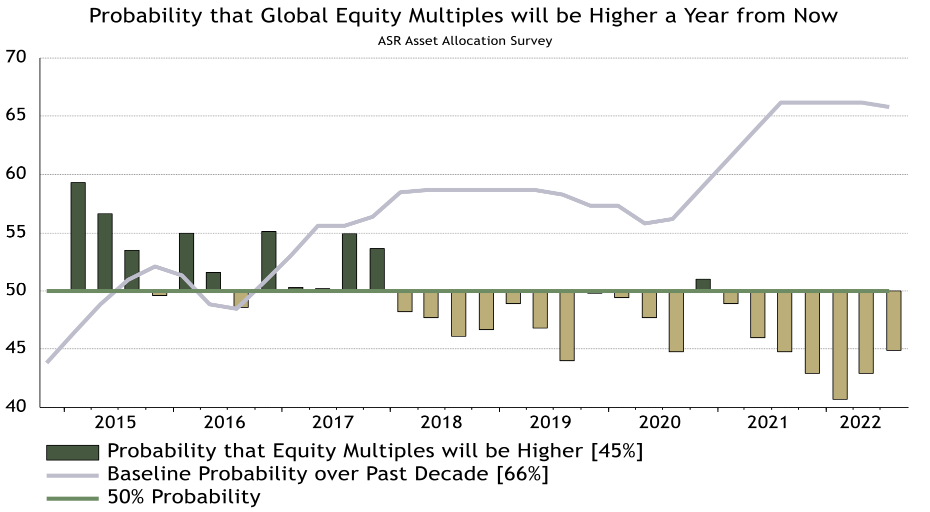
AAS.22: Probability that Global Corporate Earnings will be Higher

… held back by a strikingly negative Global Corporate Earnings outlook

Source: ASR Ltd. / Refinitiv Datastream

AAS.23: Probability that Global Equity PEs are Higher in 12m Time

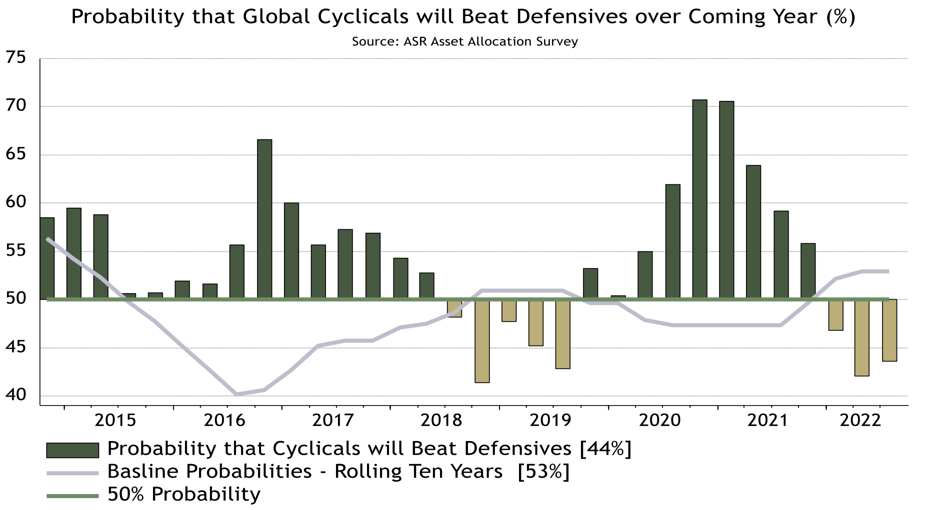
… that investors do not expect to be offset by higher Equity valuations



Source: ASR Ltd. / Refinitiv Datastream

There is a 44% probability that Cyclicals will beat Defensives (the fourth weakest reading on record)

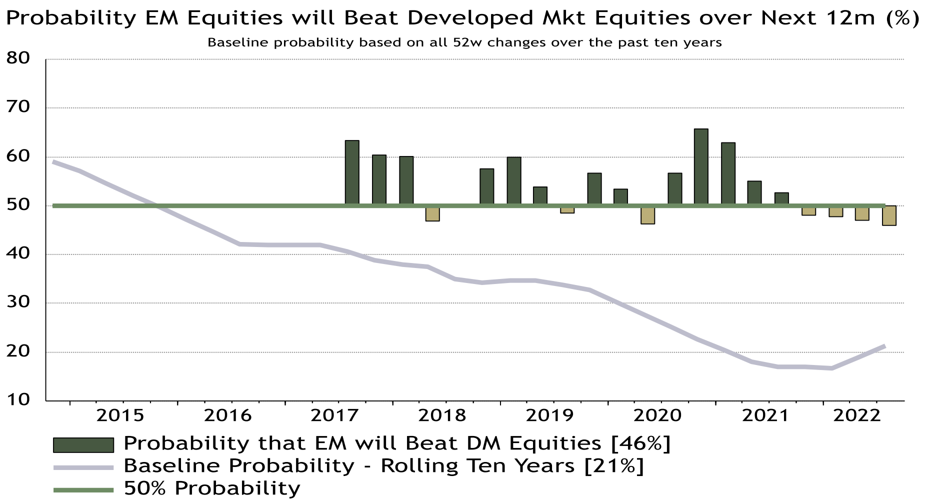
AAS.24: Probability that Cyclicals will Outperform Defensives…



Source: ASR Ltd. / Refinitiv Datastream

Investors continue to be downbeat about EM Equities vs their developed-market peers

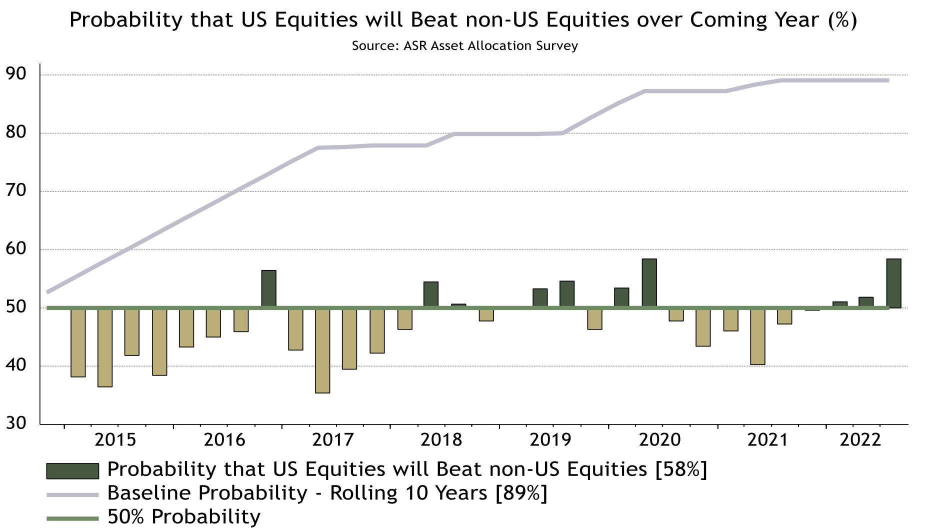
AAS.25: Probability that EM Equities will Beat DM Equities …



Source: ASR Ltd. / Refinitiv Datastream

There is a strong preference for US Equities over non-US ('international') peers

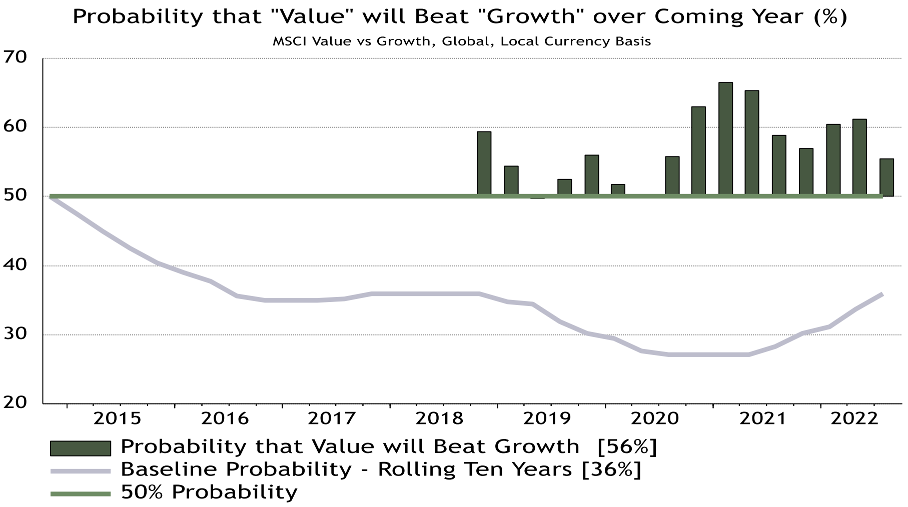
AAS.26: Probability that US Equities will Beat non-US Equities …



Source: ASR Ltd. / Refinitiv Datastream

AAS.27: Probability that Global 'Value' will Beat Global 'Growth' ...

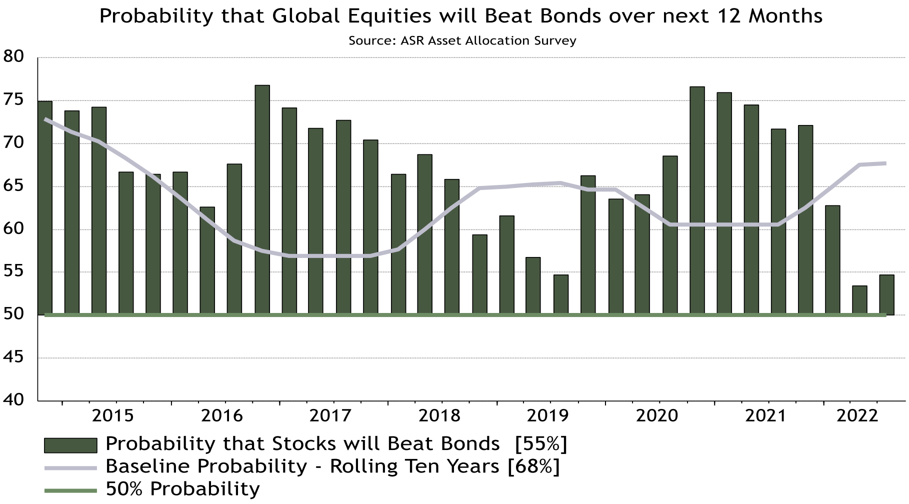
Asset allocators have trimmed their preference for Value over Growth



Source: ASR Ltd. / MSCI / Refinitiv Datastream

AAS.28: Probability that Global Equities will Beat Global Bonds ...

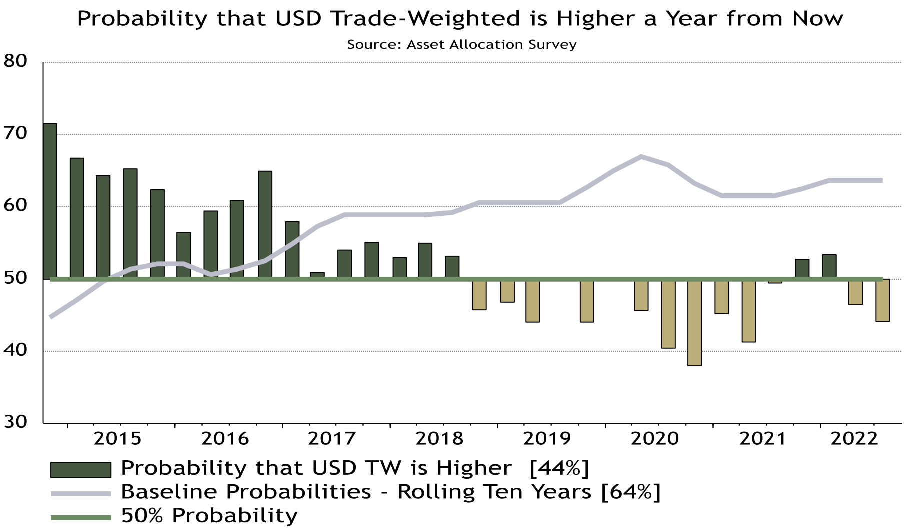
The implied probability that Stocks will outperform Bonds remains subdued at 55% (the second lowest reading in the eight-year history of the survey)



Source: ASR Ltd. / Refinitiv Datastream

AAS.29: Probability that US Dollar will be Higher a Year from Now

The 5% rise in the DXY trade-weighted index since the June 2022 survey may have taken the dollar above levels that investors think are sustainable. This - together with hopes of Fed easing - may be one of the reasons for the more negative expectations re the US dollar



Source: ASR Ltd. / Refinitiv Datastream

Charles Cara

Belief in Recovery Divides Panel into Bulls and Bears

We found just two groups for the third survey in a row

For the third survey in a row, our panel divides neatly into just two groups. But the debate has moved on from being about the severity of any upcoming recession, to being about when the recovery in the economy and risk assets might occur. It may seem a cliché, but the hackneyed labels of 'Bulls' and 'Bears' do, for once, seem appropriate.

It might be a cliché but 'Bulls' and 'Bears' best describe these groups

Most respondents are 'Bulls' but it is a narrow majority with just 57% of the panel. This group sees business confidence higher in 12 months' time, but they are not confident that there will not be a recession *and* they still think unemployment will be higher next year. Probably they are picturing the Global economy coming out of recession in 12 months' time, rather than avoiding one. In contrast, the 'Bears' believe we will still be in a recession in 12 months' time, with higher unemployment and lower business confidence than now.

Bulls expect the global economy to be recovering from a recession

What unites both groups is the belief that inflation is likely to be falling, maybe because commodity prices are expected to stabilise. However, the Bulls expect a sharper fall in inflation and less tight monetary conditions than the Bears. Accordingly, the Bulls hope that we might be near the peak for US Treasury bond yields, and that there is a chance that the curve might start to steepen in the year ahead.

Bears fear the economy will still be in decline with tighter monetary conditions

However, it is among the attitudes to risk assets where we see the biggest divergence in the two groups' views. The Bulls expect US corporate bond returns to beat Treasuries over the next 12 months and for High Yield to match Investment Grade. In contrast, the Bears see rising Credit risks, so that both HY and IG Credit are likely to underperform. The Bears are less fearful about EM Sovereign debt, but remain worried about Italian BTP/Bund spreads widening.

Bears fear falling earnings will lead to both equity and credit coming under pressure

This caution about Credit is probably driven by the Bears' conviction that corporate earnings are going to decline. The prospect of a further Equity derating leads them to expect not only lower Equity prices, but also that they could be down by more than 20%. In contrast the Bulls take a different stance, expecting only modest declines in earnings while PE multiples hold up. So, they expect global Equity prices to be higher - which obviates the need for a bear market view.

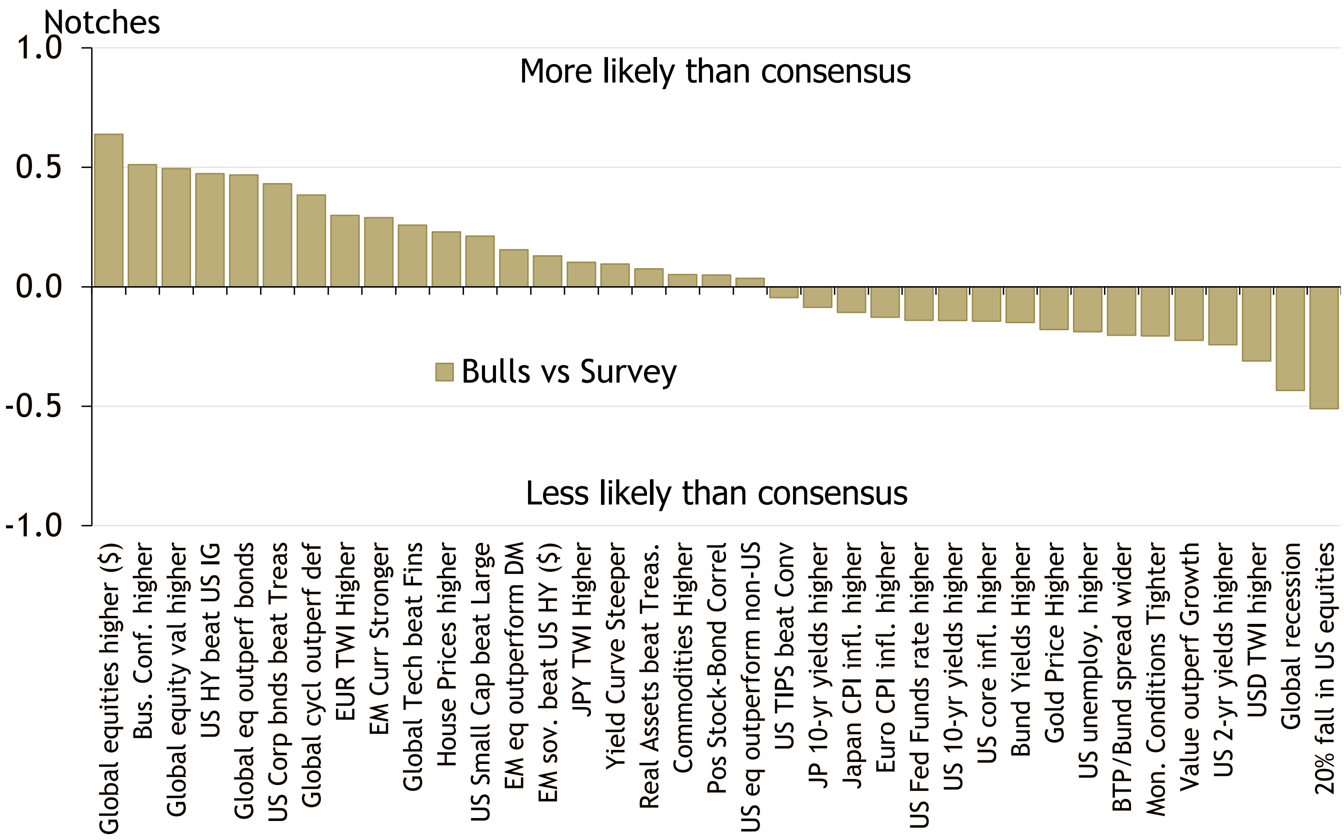
Bulls see a weaker Dollar helping earnings and equity markets

The Bears have strong views about the moves within the equity market: Cyclicals, Small Caps and EM are forecast to underperform, while Value outperforms. In contrast, the Bulls have largely neutral views on all these assets. Instead, their only strong views are that the US will beat non-US Equities and that Tech will trounce Financials. Because they are less hawkish on US interest rates, the Bulls expect the US dollar to weaken against all the other currencies.

AAS.30: Average Response of the Two Groups Identified by our Machine Learning Analysis

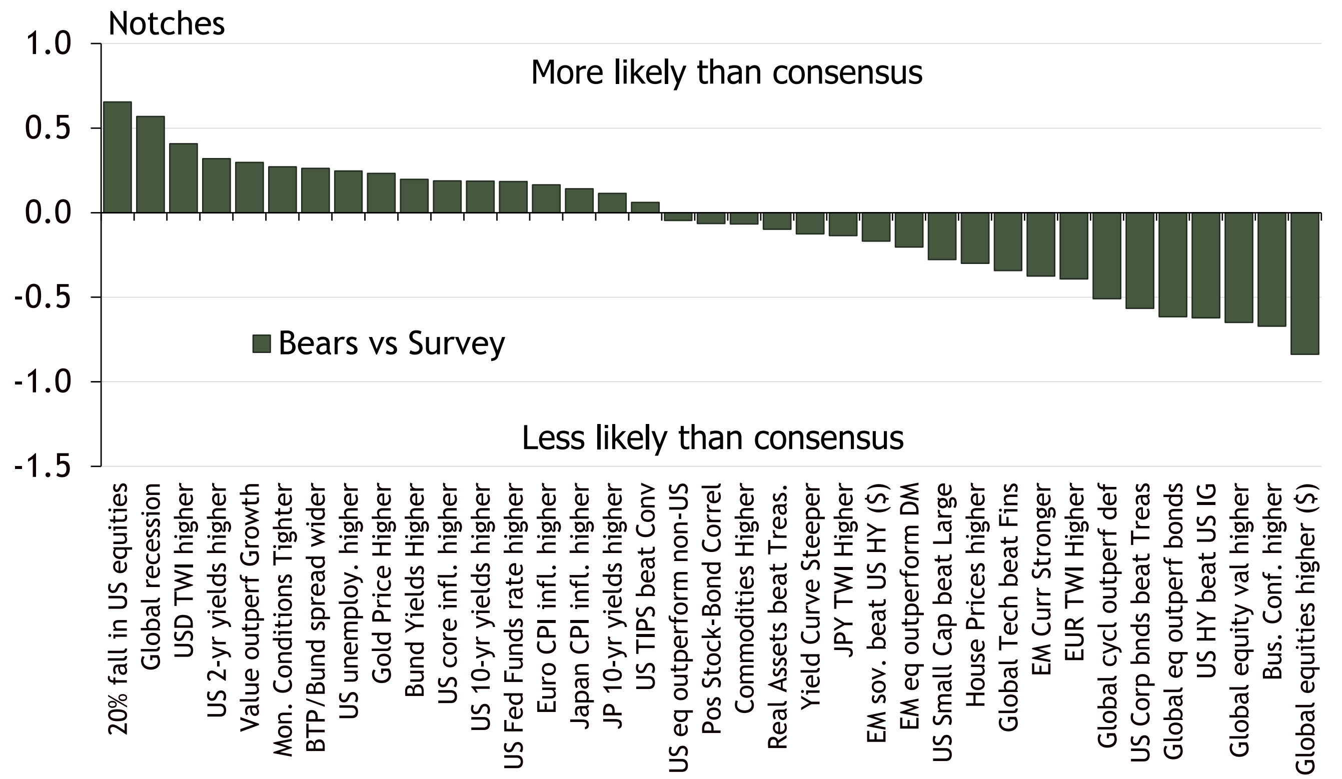
Source: ASR Ltd.

AAS.31: Comparison of 'Bulls' Group (57%) with Survey



A **Notch** is the difference between each possible answer | Source: ASR Ltd.

AAS.32: Comparison of 'Bears' Group (43%) with Survey

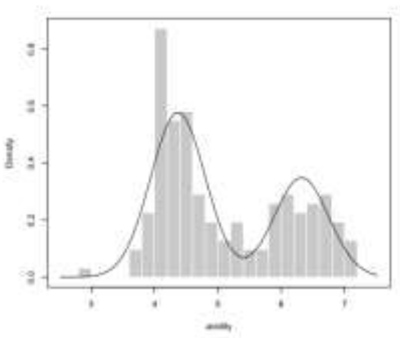


A Notch is the difference between each possible answer | Source: ASR Ltd.

Methodology - How we find our groups of similar investors

The basis of this group analysis is that there are only a limited number of generic categories of investor. An investor's answers are the combination of their generic categories' answer and some individual variation (i.e. 'noise').

AAS.33: Fitting two normal distributions to a dataset



Source: W. Härdle, Fraley & Raftery

We try to classify investors into one of these generic categories. Our approach is 'unsupervised': ahead of the analysis we do not know either the number of generic categories, or even their views! However, this is not an insurmountable problem. We can use a Bayesian approach: that is, we create a model of the generic categories and see whether we can get it to fit the data. The parameters of the model (the number of clusters and their means and variances) are then adjusted until the 'most likely' model is found. So, in the example in AAS. 33, the data are the bars, which are modelled by superimposing two normal distributions (each distribution represents a generic type). Increasing the number of distributions might lead to a better fit. However, this runs the risk of over-fitting, and so each extra group increases a penalty factor when calculating how the goodness of fit is.

Transferring this idea to our survey, the bars would be the responses to a question, and so the two distributions in the chart are equivalent to two basic investor categories. Of course, our survey has over 37 questions with discrete responses, which makes the maths more complex in practice, but we are still able to solve using the algorithms provided by the `mclust` package in R.

Implied Portfolio: Steady Risk Exposure

This 'survey consensus' portfolio is the one implied by the average panel response…

The portfolio weights shown in AAS 35 is our judgement on how the 'average' asset allocator would position their portfolio to match their views for the next 12 months, based on the survey responses. We construct this 'survey consensus' portfolio with the aim of limiting the tracking error to 0%-2.5% relative to a 'SAA benchmark index' as calculated by our [DAART risk tool](#).

…while the portfolio that reflects ASR's asset allocation views is available [here](#)

As the Implied Probabilities of the panel on the core questions of Equity Returns, Bond Yields and Equities vs Bonds are virtually unchanged, we have not changed the High-Level weights for Equities, Core Fixed Income or Alternatives.

The 'survey consensus' portfolio remains underweight Equities …

We have moved Extended Fixed Income down by 0.5%pts to 1.5% underweight to reflect the drop to 48% in the implied probability of EM Bonds vs Corporates. While that sleeve, allocations to EM Debt (External and Local) have been cut.

…but is overweight US Equities

The implied probability of Real Assets outperforming Treasuries has fallen from 70% to 57%, and Higher Commodities to 49%, so we have also cut the overweight in Alternatives from 2.5% to 1.5%, by cutting the weighting to Commodities to 0.5%.

The 'survey consensus' portfolio is also neutral on US Treasuries…

The funds released have been allocated to Cash which now stands at 4.5% overweight.

Within Equities we have reflected the panel's shift in US vs non-US views by raising the US to be 1.5% overweight from neutral, funded by proportionate cuts in the weights of the other regions.

However, the survey responses still imply an underweight position for Government Bonds in the rest of the world

Our 'survey consensus' portfolio still has a positive correlation (0.90) and beta (0.41) to equities in line with the benchmark, while the beta to rising bond yields has dropped to 1.41 compared with 1.30 for the benchmark (AAS 34).

Extended Fixed Income is underweight, reflecting the concerns about High Yield and EM debt

AAS.34: Sensitivity of 'Implied Consensus Portfolio'

Portfolio	Correlation	Beta
S&P 500	0.91	0.42
US 10y Yield	0.13	1.41
US 10yr Inflation SWAPs	0.30	4.44
Gold	0.16	0.09
Oil	0.35	0.07

Index	Correlation	Beta
S&P 500	0.90	0.41
US 10y Yield	0.12	1.30
US 10yr Inflation SWAPs	0.29	4.41
Gold	0.16	0.09
Oil	0.34	0.07

Source: ASR Ltd.

The overweight in Real Assets has been cut to reflect the fall in the belief that Real Assets will beat Treasuries

AAS.35: Implied Consensus Asset Allocation Portfolio

Portfolio	AAS Consensus	Date	09-Sep-2022

High Level Asset Allocation

	Index Weight	Portfolio	Deviation	Asset Class Risk	Intra-Asset Class Risk	Total Risk
Global Equities	47.5	46.5	-1.0	0.14	0.17	0.31
Core Fixed Income	25.0	21.5	-3.5	0.11	0.01	0.12
Extended Fixed Income	15.0	13.5	-1.5	0.06	0.01	0.08
Alternatives	10.0	11.5	1.5	0.17	0.00	0.18
Cash (US 3m T Bills)	2.5	7.0	4.5	0.02	0.00	0.02
Total	**100.0**	**100.0**	**0.0**	**0.16**	**0.20**	**0.36**
				0.46	*0.54*	

Asset Class Detail

Global Equities	Index Weight	Portfolio	Deviation	Active Risk	Annualised Vol	Ann Return
US	27.9	29.4	1.5	0.26	17.12	13.16
Eurozone	6.9	6.1	-0.8	0.16	19.65	5.05
UK	2.2	2.1	-0.1	0.02	18.68	2.92
Japan	3.3	2.8	-0.5	0.09	18.18	6.16
Australia	1.5	1.4	-0.1	0.02	19.82	4.70
EM	5.7	4.7	-1.0	0.16	15.62	2.78
Total	**47.5**	**46.5**	**-1.0**	**0.31**	**14.45**	**9.91**

Core Fixed Income	Index Weight	Portfolio	Deviation	Active Risk	Annualised Vol	Ann Return
US Treasuries	10.0	10.0	0.0	0	4.21	0.79
Bunds	4.0	3.0	-1.0	0.04	4.33	1.53
JGBs	5.0	4.0	-1.0	0.02	2.17	1.91
Gilts	1.5	1.0	-0.5	0.04	8.05	1.05
BTPs	2.0	1.0	-1.0	0.06	6.27	4.23
TIPs	2.5	2.5	0.0	0	5.16	1.59
Total	**25.0**	**21.5**	**-3.5**	**0.12**	**3.32**	**1.37**

Extended Fixed Income	Index Weight	Portfolio	Deviation	Active Risk	Annualised Vol	Ann Return
IG Corporates	8.0	8.0	0.0	0	4.85	2.32
HY Corporates	3.0	2.5	-0.5	0.03	5.13	4.45
EMD Hard External	2.0	1.5	-0.5	0.03	6.10	1.61
EMD Local	2.0	1.5	-0.5	0.03	6.60	0.56
Total	**15.0**	**13.5**	**-1.5**	**0.08**	**4.09**	**2.44**

Alternatives	Index Weight	Portfolio	Deviation	Active Risk	Annualised Vol	Ann Return
Gold	2.0	2.5	0.5	0.08	15.50	-0.91
GSCI Commodities	2.0	2.5	0.5	0.11	21.78	-3.53
Listed Infrastructure	3.0	3.3	0.3	0.04	14.72	7.14
Listed Real Estate	3.0	3.3	0.3	0.04	14.61	4.89
Total	**10.0**	**11.5**	**1.5**	**0.18**	**11.60**	**2.44**

	Annualised Vol	Ann Return
Total Index	**7.88**	**5.55**
Total Portfolio	**7.88**	**5.56**

Source: ASR Ltd.

AAS.36: Summary of Responses – 2022 Q3

	Proportion of Panel					Implied
(%)	Very Likely	Likely	Even Chance	Unlikely	Very Unlikely	Probability
Business confidence higher	6	32	24	30	8	50
Global recession in 12 months	18	43	22	15	1	62
US unemployment rate higher	47	40	9	3	0	76
US Inflation higher	2	5	8	51	34	28
Eurozone Inflation higher	2	14	16	44	24	35
Japan Inflation higher	3	20	37	29	12	45
US Fed Funds rate higher	49	36	8	5	2	75
Monetary Conditions Tighter	38	38	15	8	2	71
US 2-year Treasury yields higher	12	34	28	21	4	56
US 10-year Treasury yields higher	14	33	25	23	5	55
US Yield Curve Steeper	14	45	19	19	3	59
Japan 10-yr yields higher	12	40	34	11	2	60
Bund Yields Higher	20	40	23	14	3	62
BTP/Bund spread wider	19	48	21	10	2	65
US TIPS beat Conventionals	7	25	29	34	6	49
US Corporate Bonds beat Treasuries	5	36	26	29	4	52
US HY beat US IG	3	22	19	43	12	42
EM sov. beat US HY ($)	4	28	28	34	7	48
Global equities outperform bonds	11	33	32	20	5	55
Positive Stock-Bond Correlation	7	31	33	27	2	53
Real Assets beat Treasuries	9	43	22	22	4	57
House Prices higher	3	9	14	40	34	32
Global corporate earnings higher	3	13	17	49	18	37
Global equity valuations higher	4	23	27	35	11	45
Global equities higher ($)	7	29	30	25	9	50
20% drawdown in US equities	11	29	29	27	5	53
US equities outperform non-US	8	47	27	15	3	58
EM equities outperform DM	4	24	26	37	8	46
Global cyclicals outperf defensives	1	23	26	43	7	44
Value outperforms Growth	5	41	32	20	2	56
Global Technology beat Financials	5	33	33	26	4	52
US Small Cap beat Large	3	22	31	37	7	46
Gold Price Higher	10	35	35	17	3	57
USD TWI higher	5	20	25	42	8	44
EUR TWI Higher	3	38	27	26	5	52
JPY TWI Higher	9	35	37	16	4	56
EM Currencies Stronger	3	35	31	27	5	51
Commodities Higher	5	27	31	30	7	49

Source: ASR Ltd.

Our 245 panellists work in teams that manage over $4.8trillion of assets. The fieldwork for the survey was conducted through an on-line survey between 25th August to 8th September 2022.

Methodology – What we Mean by 'Implied Probabilities'

- ASR's Multi-Asset Survey is a Survey of Probabilities.
- Every quarter we contact over 200 asset allocators and multi-asset strategists from around the world.
- We ask them "how likely" they think certain financial and economic events are to occur in the next 12 months. All thirty questions are framed with a binary outcome (will 'X' happen, or will it not happen?) with a fixed time horizon. Each question offers five options: (1) very likely (2) somewhat likely, (3) even chance, (4) somewhat unlikely, (5) very unlikely.
- We then ascribe notional probabilities to each of the five options. For example, if someone responds, "very likely", we apply a 90% probability to their response, "somewhat likely" is given a 70% probability. If they reply, "very unlikely", we apply a 10% probability. If someone says, "even chance", then we apply a 50% probability.
- By applying different probabilities to the responses, we can calculate an overall probability. This is more sophisticated than other surveys, which just calculate a "net balance" (e.g. % respondents that are 'optimists' minus % respondents that are 'pessimists'). Our approach captures differences in convictions.
- Small changes in the implied probabilities matter: a 5%-point change over a quarter can indicate an important shift. A 10%-point change can reflect a profound change in expectations.
- These "implied probabilities" are powerful as they can be used in multiple ways. First, we can compare them with the probabilities that are implied in the market. Secondly, we can compare them with our own views and see where we are most different from the consensus. And thirdly, we can compare them with the historic baseline probability (how often has this event occurred over the past decade).
- For example, an implied probability of 50% may sound like a neutral call, but if the event has only occurred 20% of the time over the past decade, then this 50% probability is in fact a much more aggressive call that it may first appear. It is 'big' relative to the history of the past ten years.

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