



# Global Asset Allocation Viewpoints and Investment Environment

OCTOBER 2019

## 1 Portfolio Positioning

As of 30 September 2019

### Uneasy Equilibrium



- We remain **broadly neutral** from a risk standpoint with a modest underweight to equities and are finding pockets of opportunity to add yield in lieu of capital appreciation.
- Within developed markets outside the U.S., we **reduced our exposure to growth stocks in favor of value** as relative valuations are stretched, considering supportive central bank policy responses.
- Within fixed income we **added to floating rate loans** as they offer attractive yields with reasonable valuations.

## 2 Market Themes

As of 30 September 2019

### Easy money, again

The dovish shift of monetary policy this year has been dramatic as negative trade headwinds and geopolitical uncertainty are weighing on growth. So far, 21 central banks have moved into outright easing mode, which should help stabilize global growth and allay fears of an impending recession. However, monetary policy is at an unusual starting point. After a decade of unprecedented monetary stimulus around the world, rates are already at historically low levels and inflation remains stubbornly low, raising questions on its effectiveness. While policymakers continue to stress that they are ready to do more, policy has been restrained and largely reactive to date, allowing trade negotiations to drive the macro outlook.

### Head fake?

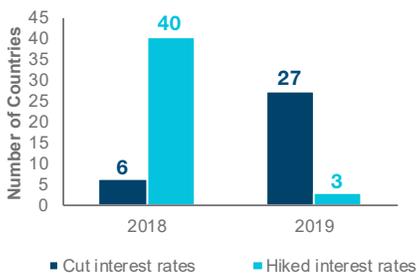
In late August/early September, equity markets experienced a sharp rotation out of momentum-driven growth stocks into more cyclically oriented value names. This was a significant reversal in leadership as cyclical companies had long been shunned by investors amid weak global growth, while defensive growth stocks continued to lead. Bond markets similarly showed signs of inflection as interest rates bucked their downward trend, reversing a large part of August's steep decline. Was this an unwind of extended growth equity valuations and overly bearish sentiment that sent rates to record lows? Or does the market truly believe that economic growth will pick up enough to sustain earnings and price momentum of cyclical sectors?

### Achtung!

While sentiment within eurozone services has remained resilient, confidence within manufacturing dropped to its worst level in nearly seven years. The decline, largely driven by weakness in Germany, the region's largest economy, has raised fears that Europe may be headed for a recession. Uncertainty surrounding Brexit, trade disputes, and issues in the auto industry have all weighed on growth within the region. Monetary policymakers have already stepped back in to support growth, and after years of austerity, an increasing number of countries are expected to provide fiscal stimulus. The question remains whether policymakers can deliver enough support to avert a third euro-area recession in the past decade.

### Central Bank Action Comparison

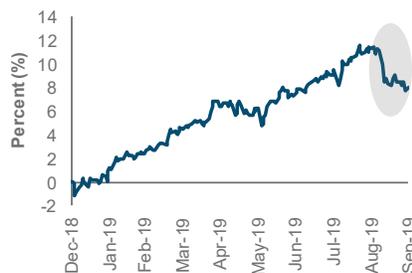
As of 30 September 2019



Source: International Monetary Fund (IMF). Analysis based on the 30 largest IMF countries based on GDP (nominal).

### MSCI ACWI Index Growth Less Value

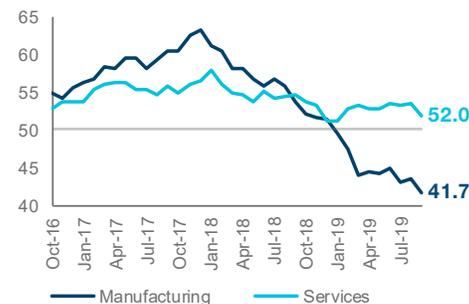
31 December 2018 to 30 September 2019



Shading represents inflection point on the chart. Source: Financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved. Based on daily returns.

### Germany PMI

30 September 2016 to 30 September 2019



Source: Markit Economics Limited. Please see additional disclosures on the final page.

Past performance is not a reliable indicator of future performance.  
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# 3 Regional Backdrop

As of 30 September 2019



## Positives

## Negatives

### United States

- Fed easing, low inflation
- Healthy consumer spending, strong employment, and improving wages
- Low interest rates driving a rebound in housing
- Pause in trade war escalation
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

- Political uncertainty
- Modest economic growth with fading fiscal stimulus
- Muted near-term earnings expectations
- Weak capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and corporate margins under pressure
- Elevated corporate and government debt levels

### Europe

- Monetary policy remains very accommodative
- Indirect beneficiary of China stimulus
- Services sector of the economy resilient
- Dividend yields remain strong

- Economic growth is muted, with notable weakness in the manufacturing sector
- Limited scope for ECB to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains challenged
- Brexit uncertainty weighing on sentiment

### Developed Asia/Pacific

- Further China stimulus could support regional trade
- Dovish stance from both the BOJ and RBA
- Broadly attractive valuations, particularly in Japan
- Improving corporate governance trends in Japan

- Highly sensitive to global industrial production trends and trade tensions
- Australia facing slowing economy with weakness in housing
- Australian earnings facing increased margin pressure

### Emerging Markets

- Muted (but rising) inflation, more dovish Fed has given central banks flexibility to ease
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle
- Beneficiary of China stimulus

- Export-driven economies are highly vulnerable to rising trade tensions
- Instability in several key markets (Turkey, Argentina, and Brazil) could persist
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused

# 4 Asset Allocation Committee Positioning

As of 30 September 2019

|                      |                               | Underweight  | Neutral | Overweight | ▼ or ▲ Month-Over-Month Change |
|----------------------|-------------------------------|--|---------|------------|--------------------------------|
|                      |                               |  |         |            |                                |
|                      |                               |  |         |            |                                |
|                      |                               | <b>These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.</b> |         |            |                                |
| ASSET CLASS          | Equities                      |  |         |            |                                |
|                      | Bonds                         |  |         |            |                                |
|                      | Cash                          |  |         |            | ▼                              |
|                      | <i>Regions</i>                |  |         |            |                                |
|                      | U.S.                          |  |         |            |                                |
|                      | Global Ex-U.S.                |  |         |            |                                |
|                      | Europe                        |  |         |            |                                |
|                      | Japan                         |  |         |            |                                |
|                      | Emerging Markets              |  |         |            |                                |
|                      | <i>Style</i>                  |  |         |            |                                |
| EQUITIES             | U.S. Growth                   |  |         |            |                                |
|                      | U.S. Value                    |  |         |            |                                |
|                      | Global Ex-U.S. Growth         |  |         |            | ▼                              |
|                      | Global Ex-U.S. Value          |  |         |            | ▲                              |
|                      | <i>Capitalization</i>         |  |         |            |                                |
|                      | U.S. Large-Cap                |  |         |            |                                |
|                      | U.S. Small-Cap                |  |         |            |                                |
|                      | Global Ex-U.S. Large-Cap      |  |         |            |                                |
|                      | Global Ex-U.S. Small-Cap      |  |         |            |                                |
|                      | <i>Inflation-Sensitive</i>    |  |         |            |                                |
| Real Assets Equities |                               |  |         |            |                                |
| BONDS                | U.S. Investment Grade         |  |         |            |                                |
|                      | Developed Ex-U.S. IG (Hedged) |  |         |            |                                |
|                      | Inflation-Linked              |  |         |            |                                |
|                      | Global High Yield             |  |         |            |                                |
|                      | Floating Rate Loans           |  |         |            | ▲                              |
|                      | EM Dollar Sovereigns          |  |         |            |                                |
|                      | EM Local Currency             |  |         |            |                                |

**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**

Limited upside with above-average valuations and risks elevated; fragile global growth and vulnerable to further political uncertainty.

Valuations extended with yields low due to growth concerns, trade uncertainty, and muted inflation; credit spreads tight but fundamentals supportive.

U.S. yields most attractive among developed markets but past peak with Fed easing.

*Regions*

U.S. Earnings growth weak on margin pressure and valuations above average; U.S. market less sensitive to global growth concerns and potentially easier comparables in 2020.

Global Ex-U.S. Central banks supportive and valuations attractive relative to history amid concerns over manufacturing slowdown and trade uncertainty.

Europe Growth outlook under pressure amid concerns over exports, banking system, and elevated political risks; potential tailwind from monetary and fiscal stimulus.

Japan Monetary and fiscal policy supportive; export dependency and stronger yen potential headwinds.

Emerging Markets Beneficiary of China stimulus measures, Fed easing, and cheap currencies supportive; susceptible to trade concerns and earnings weakness.

*Style*

U.S. Growth Secular growth companies less sensitive to macro environment; tech supply chains are at risk and regulatory concerns are growing.

U.S. Value Valuations fair but lack catalyst with modest economic growth and flat yield curve.

Global Ex-U.S. Growth Sector profile has defensive and quality growth bias; valuations extended versus history.

Global Ex-U.S. Value Cyclical orientation and financials exposure challenged by macro environment; cheap valuations beginning to look extreme.

*Capitalization*

U.S. Large-Cap Earnings outlook uninspiring with strong USD a headwind; valuations trending above historical averages.

U.S. Small-Cap Valuations attractive and benefit from low rates; high leverage and wage pressure are risks.

Global Ex-U.S. Large-Cap Central banks supportive, potential beneficiary of further China stimulus; susceptible to global trade weakness.

Global Ex-U.S. Small-Cap Weak domestic growth trends and political uncertainty weighing on confidence in key markets.

*Inflation-Sensitive*

Real Assets Equities Sluggish global growth outlook weighing on commodities; U.S. REITs supported by healthy fundamentals and low rates.

U.S. Investment Grade Yields low but anchored due to limited inflation upside; IG corporate spreads remain tight relative to history.

Developed Ex-U.S. IG (Hedged) Central banks supportive, hedged USD yields attractive, but durations remain extended.

Inflation-Linked Inflation expectations low but rising with coordinated central bank easing.

Global High Yield Yield carry attractive with near-term default expectations low, but late stage of credit cycle a risk.

Floating Rate Loans Yield level remains attractive with near-term recession risk low; step-ups less likely with Fed easing, and liquidity remains a concern.

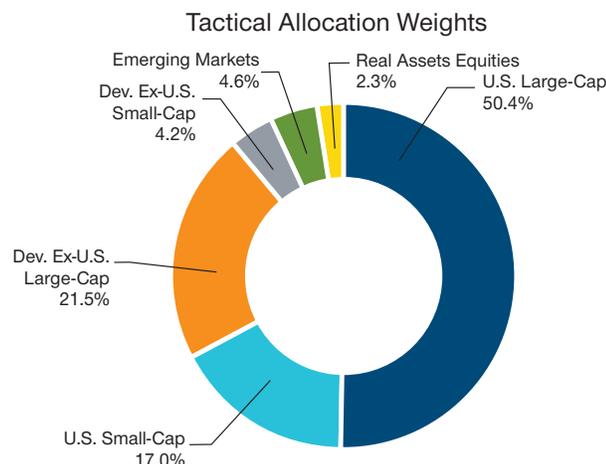
EM Dollar Sovereigns Yields are attractive and central banks supportive; idiosyncratic risks and potential contagion remain concerns.

EM Local Currency EM currency valuation remains attractive; volatility likely to be driven by trade tensions and persistent USD strength.

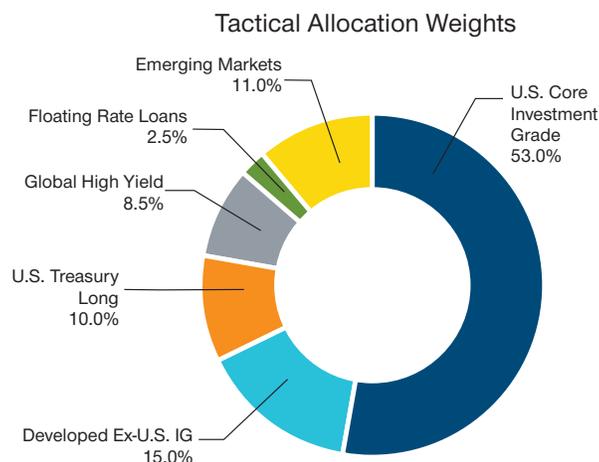
# 5 Portfolio Implementation

As of 30 September 2019

| Equity                        | Neutral Weight | Tactical Weight | Relative Weight |
|-------------------------------|----------------|-----------------|-----------------|
| ■ U.S. Large-Cap              | 51.0%          | 50.4%           | -0.6%           |
| ■ U.S. Small-Cap <sup>1</sup> | 15.0%          | 17.0%           | +2.0%           |
| ■ Dev. Ex-U.S. Large-Cap      | 21.0%          | 21.5%           | +0.5%           |
| ■ Dev. Ex-U.S. Small-Cap      | 4.0%           | 4.2%            | +0.2%           |
| ■ Emerging Markets            | 4.0%           | 4.6%            | +0.6%           |
| ■ Real Assets Equities        | 5.0%           | 2.3%            | -2.7%           |
| <b>Total Equity:</b>          | <b>100.0%</b>  | <b>100.0%</b>   |                 |



| Fixed Income                               | Neutral Weight | Tactical Weight | Relative Weight |
|--|----------------|-----------------|-----------------|
| ■ U.S. Core Investment Grade               | 55.0%          | 53.0%           | -2.0%           |
| ■ Developed Ex-U.S. IG (Hedged)            | 15.0%          | 15.0%           | 0.0%            |
| ■ U.S. Treasury Long                       | 10.0%          | 10.0%           | 0.0%            |
| ■ Global High Yield                        | 8.0%           | 8.5%            | +0.5%           |
| ■ Floating Rate Loans                      | 2.0%           | 2.5%            | +0.5%           |
| ■ Emerging Markets - (Local/Hard Currency) | 10.0%          | 11.0%           | +1.0%           |
| <b>Total Fixed Income:</b>                 | <b>100.0%</b>  | <b>100.0%</b>   |                 |



<sup>1</sup>U.S. small-cap includes both small- and mid-cap allocations.

Source: T. Rowe Price. Unless otherwise stated, all market data are sourced from FactSet. Copyright 2019 FactSet. All Rights Reserved.

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Neutral equity portfolio weights representative of a U.S.-biased portfolio with a 70% U.S. and 30% international allocation; includes allocation to real assets equities. Core fixed income allocation representative of U.S.-biased portfolio with 55% allocation to U.S. investment grade.

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