Global Asset Allocation Viewpoints and Investment Environment

1 MARKET THEMES

As of June 30, 2019

DON'T FIGHT THE FED?

Global manufacturing data continued to sow doubts on the outlook for economic growth as the impact of lingering trade uncertainty on corporate sentiment has become more pronounced. Data has continued to weaken over the first half of the year with the global manufacturing PMI falling below the expansion threshold in June, marking the lowest level since February 2016. Weakness was broad-based with the headline number and new orders falling in all regions. Despite these persistent signs of a weakening global environment, markets seem confident that central banks will provide a backstop. So far, central bank rhetoric has supported markets but, if needed, will the response be sufficient to reverse the economic trend?

SYNCHRONIZED PIVOT

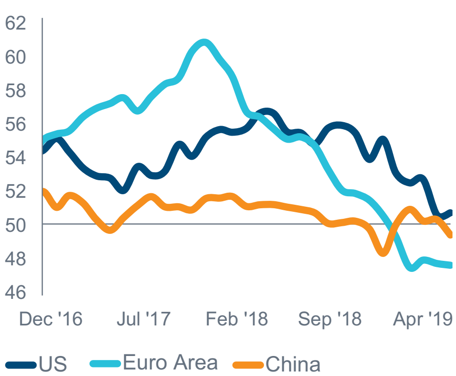
Macro risks remain to the downside as business sentiment and global capex have been adversely impacted by trade uncertainty leading expectations for central bank easing to become increasingly synchronized. Following the pivot by the U.S. Federal Reserve, recent comments from ECB President Draghi increased expectations that monetary easing would be forthcoming in the eurozone, and Australia has moved to an easing stance. This could be good news for emerging markets as dovishness in developed markets and signs that the U.S. dollar strengthening trend may have peaked would provide cover to cut rates amid still low inflation.

TRUCE BUT NOT REAL PROGRESS

While expectations for the Trump and Xi meeting at the G-20 Summit were low, the resulting truce is a positive development following months of escalating tensions. But will it be enough to support markets from here? Risk assets had already rallied strongly year-to-date on the back of dovish comments from the Fed and the ECB, with U.S. equities posting the best start to the year since 1997. However, recent strength of safe-haven assets, such as gold and sovereign bonds raises some concerns. While the truce avoided further escalation, the core issues (e.g., intellectual property) remain unresolved. While markets rejoiced in the detente, there are no clear signs that the trade war is over.

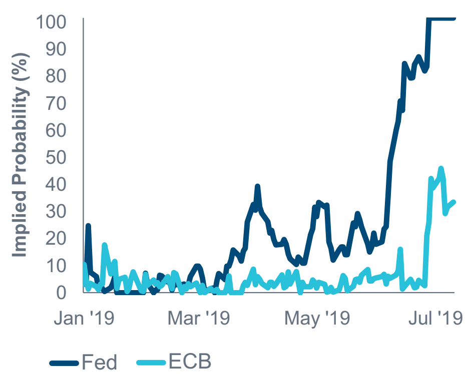
MANUFACTURING PMI

December 31, 2016 to June 30, 2019



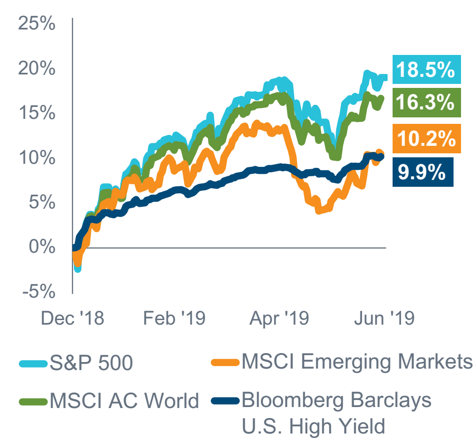
FUTURES MARKET EXPECTATIONS FOR RATE CUTE IN JULY

December 31, 2018 to June 30, 2019



YEAR-TO-DATE TOTAL RETURN

Figures are in USD as of June 30, 2019



Past performance is not a reliable indicator of future performance.

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2 Regional Backdrop

As of June 30, 2019

UNITED STATES

Positives

- Dovish Fed, stable inflation
- Healthy consumer spending, strong employment, and improving wages
- Lower 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 world

Negatives

- Election in 2020
- Slowing economic growth with fading fiscal stimulus
- Muted near-term earnings expectations
- Faltering capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and elevated margins
- Elevated corporate and government debt levels

EUROPE

Positives

- Monetary policy remains very accommodative
- Indirect beneficiary of China stimulus
- Economic growth showing signs of improvement
- Dividend yields remain strong

Negatives

- Economic growth is muted
- Limited scope for ECB to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains challenged
- The composition of the new EU Parliament could lead to difficulties

DEVELOPED ASIA & PACIFIC

Positives

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

Negatives

- Highly exposed to slowing global economic growth and trade tensions
- Japanese economic and earnings growth continue to be weak, VAT increase looms
- Australia facing slowing economy with weakness in housing
- Australian earnings facing increased margin pressure

EMERGING MARKETS

Positives

- Muted inflation, more dovish Fed give central banks flexibility to ease
- Beneficiary of Chinese stimulus
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle

Negatives

- 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

PORTFOLIO POSITIONING

As of June 30, 2019

EXECUTIVE SUMMARY

The T. Rowe Price Asset Allocation Committee evaluates the relative attractiveness of major asset classes over a 6- to 18-month time horizon. These positions are currently reflected across our family of multi-asset investment strategies.

UNCERTAINTY WARRANTS CAUTION

- We **remain modestly underweight equities in favor of cash and bonds** as valuations are extended against a backdrop of rising risks.
- We **favor high yield bonds** as yield levels remain attractive and fundamentals healthy. Relative to equities, high yield bonds currently offer similar return expectations with a lower volatility profile.
- We are **overweight emerging market equities** as they should benefit from the trade truce, dovish central banks, and a weaker U.S. dollar.

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ASSET ALLOCATION COMMITTEE POSITIONING

As of June 30, 2019

Bonds | Neutral | Stocks

	■			

UNDERWEIGHT | CURRENT POSITION | OVERWEIGHT

Bond yields are lower, amid slowing global growth.

EQUITIES

U.S. | Neutral | International

			■	

International equities have attractive valuations but fading global growth and trade risks present headwinds.

Developed | Neutral | Emerging

			■	

Emerging markets equities are attractive, supported by a more dovish Federal Reserve.

Global Equity | Neutral | Real Assets

■				

Declining global growth outlook and oversupply could weigh on energy and commodity prices.

Large-Cap | Neutral | Small-Cap

			■	

U.S. small-cap equities are attractive but face late-cycle pressures.

U.S. Value | Neutral | U.S. Growth

			■	

U.S. growth stocks could offer potential upside in a lower-growth environment, while U.S. value stocks lack a catalyst to advance.

EQUITIES (CONT.)

International Value | Neutral | International Growth

			■	

International value stocks may be challenged by broad economic weakness.

FIXED INCOME

U.S. Investment Grade | Neutral | U.S. High Yield

			■	

High yield corporate fundamentals remain broadly positive with low default expectations.

U.S. Investment Grade | Neutral | Emerging Markets

			■	

Broad emerging markets debt yields are attractive, but country-specific risks are on the rise.

U.S. Investment Grade | Neutral | Ex U.S. Investment Grade

		■		

International bond durations remain extended.

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