Global Asset Allocation Viewpoints and Investment Environment

1 MARKET THEMES

As of March 31, 2020

CUSHIONING THE BLOW

Pledges of fiscal spending have been quick to follow actions taken by major central banks to combat the looming impacts of the coronavirus pandemic. G-20 countries have pledged more than $5 trillion USD in stimulus through a wide range of avenues to stave off the effects on the global economy. The U.S. has passed a record-setting $2 trillion USD stimulus package, nearly 10% of its gross domestic product, that includes checks paid directly to families as well as loans and guarantees to impacted sectors, including airlines, hotels, and hospitals. Other major countries have followed suit, with a similar emphasis of broad support to both workers and businesses, large and small. While the measures thus far have been quick to be enacted, their effects will take months to come through and positively impact the economy. Only time will tell if these efforts will be enough to offset the damage thus far. The longer the pandemic keeps the global economy on pause, the more support it is going to need to bounce back.

HOW LOW CAN IT GO?

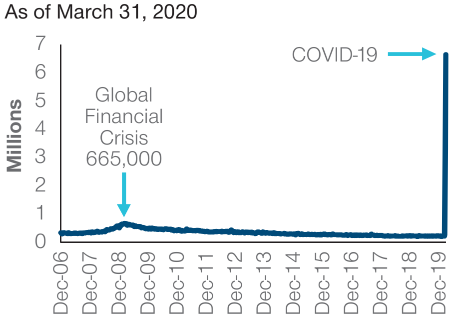
Oil prices slid more than 60% in the first quarter while many oil stocks have lost more than half their value. If the demand-destructing impacts of the coronavirus-related shutdowns were not bad enough, already oversupplied markets were challenged by the market share war between Saudi Arabia and Russia, which is now showing signs of healing. While the steep decline in oil prices has resulted in low fuel prices not seen in decades, with current social distancing measures in place, consumers and airlines are unable to take advantage of the low levels. With prices near $20 USD per barrel many producers are operating well below their break-even levels, notably U.S. shale producers that continue to operate to generate cashflow despite the low levels. The rising risk is evident in the U.S. high yield market–with approximately a 10% exposure to energy–as yields have blown out to more than 10%. While the battle between OPEC+ members may be resolved, lingering structural imbalances and the severity of the economic downturn will further weigh on the sector.

EMERGENCY PLUMBING FIX

As markets faced sharp declines in response to the coronavirus outbreak, liquidity strains in bond markets exacerbated the situation as investors flocking out of bonds were unable to find buyers in the open market and forced to sell at unattractive levels. Some of this issue can be attributed to dispersed traders and the sheer magnitude of the outflows coming from bonds, but the crux of the issue lies with the enhanced regulations placed on banks after the global financial crisis–limiting banks ability to leverage their balance sheets–leaving fewer buyers to step in. In rapid response to the looming liquidity crisis, the Fed swiftly injected a massive amount of liquidity into markets including unlimited, open-ended quantitative easing, as well as corporate and municipal government bond-buying, in hopes to instill a floor in bond pricing. For now, the extreme measures appear to be alleviating some of the pain as credit markets have shown signs of stabilization. However, it remains to be seen if these measures will be enough to get markets through this crisis, otherwise the Fed may need to show what they meant by “whatever it takes.”

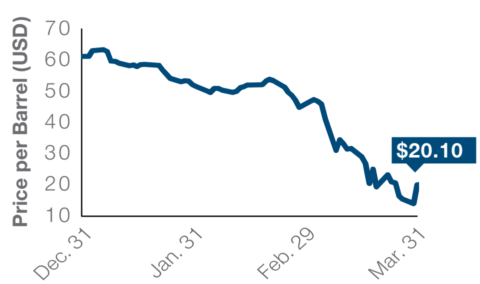
U.S. INITIAL CLAIMS FOR UNEMPLOYMENT INSURANCE

As of March 31, 2020



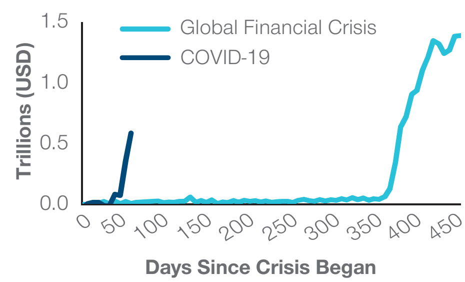
WTI CRUDE OIL PRICE

As of March 31, 2020



FED BALANCE SHEET CHANGES SINCE THE BEGINNING OF CRISES

As of March 31, 2020



Past performance is not a reliable indicator of future performance.

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2 Regional Backdrop

As of 31 March 2020

	Positives	Negatives
UNITED STATES	▪ Unprecedented levels of monetary and fiscal support ▪ Healthy consumer balance sheets prior to the crisis ▪ Pause in trade war escalation ▪ Health care infrastructure is stronger than most regions ▪ Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world	▪ Size of country and freedom of movement means there is higher potential for continued outbreaks ▪ Elevated corporate leverage going into the crisis ▪ Service-oriented economy, means higher economic impact from social distancing ▪ Margins under pressure going into the crisis ▪ Elevated government debt levels
EUROPE	▪ Long awaited fiscal stimulus measures are finally coming ▪ Monetary policy remains very accommodative ▪ Inexpensive valuations have become even more inexpensive as Europe has born the brunt of the sell-off	▪ Weak economic growth going into crisis ▪ Limited scope for the European Central Bank (ECB) to stimulate further ▪ De-centralized government structure means fiscal response is somewhat delayed ▪ Banking sector was weak going into the crisis
DEVELOPED ASIA & PACIFIC	▪ Outbreaks in this region have thus far been milder than in the rest of the world ▪ Strong and aggressive fiscal stimulus ▪ Japanese companies generally hold high cash levels, meaning they have more cushion for weakness	▪ Highly sensitive to global industrial production and trade trends ▪ Australia holds high exposure to natural resource prices, which have weakened considerably
EMERGING MARKETS	▪ Virus outbreak in China appears to be contained ▪ Policy response from China has been significant ▪ Younger population likely to be less affected by virus ▪ Dovish Fed has given emerging markets central banks flexibility to ease ▪ Easing trade tensions ▪ Equity valuations attractive relative to developed markets	▪ Weak health care infrastructure in many regions ▪ Limited ability to enact fiscal stimulus (excluding China) ▪ Highly sensitive to global industrial production and trade trends ▪ Commodity prices under pressure ▪ Instability in several key markets could weigh on sentiment ▪ Potential for elevated currency volatility

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 as of March 31, 2020.

LEANING INTO WEAKNESS

- Amid the coronavirus-related sell-off in risk assets, we have incrementally added to equities over the month as the broad-based, indiscriminate selling has created opportunities to buy into quality companies at discounted levels. We are averaging into positions as volatility is likely to persist over the near term and markets could revisit recent lows.
- We have pared back exposure to higher-quality, U.S. Treasuries that have reached extreme valuations as yields have fallen to record-low levels.
- Within fixed income, we added to high yield bonds as spreads have reached attractive entry points that historically have led to the sector delivering equity-like returns, with lower volatility over our 12- to 18-month investment horizon.
- We also added modestly to floating rate loans as the sector has sold off, leaving spreads at historically attractive levels relative to high yield bonds; loans also have less exposure to the energy sector and higher standing in the capital structure.

4 ASSET ALLOCATION COMMITTEE POSITIONING

As of March 31, 2020

Bonds | Neutral | Stocks

UNDERWEIGHT | CURRENT POSITION | OVERWEIGHT

Equity prices are attractive amid the market sell-off, but the coronavirus pandemic clouds the near-term outlook.

EQUITIES

U.S. | Neutral | International

International stocks have cheaper valuations relative to the U.S., but fragile economies face contraction amid the virus spread.

Developed | Neutral | Emerging

Emerging markets stocks are cheap and may benefit from increased stimulus efforts and successful virus containment in China.

Global Equity | Neutral | Real Assets

Commodity prices are pressured by the oil price war and the demand shock as the pandemic impedes global economic activity.

U.S. Large-Cap | Neutral | U.S. Small-Cap

U.S. large-cap valuations are lower, but they are vulnerable to global supply chain disruption and disappointing earnings.

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

U.S. growth stocks are less sensitive to broad economic events, while U.S. value stocks are attractive after the sell-off.

EQUITIES (CONT.)

International Value | Neutral | International Growth

International value stocks are significantly cheaper and could provide compelling upside if growth stabilizes.

FIXED INCOME

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

Treasury yields are near record-low levels, while high yield credit spreads are at historically attractive levels.

U.S. Investment Grade | Neutral | Emerging Markets

Despite idiosyncratic challenges, emerging markets debt offer relatively attractive valuations.

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

Hedged U.S. dollar yields are attractive given the interest rate differential, while U.S. investment-grade bonds are expensive.

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Portfolio Allocations are subject to change without further notice. 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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