GLOBAL ASSET ALLOCATION: THE VIEW FROM EUROPE

January 2021

MARKET INSIGHTS

As of 31 December 2020

Chasing Unicorns

Unprecedented monetary and fiscal stimulus and late-year positive news on vaccines fueled a relentless rally in risk assets in 2020, with the S&P 500 Index returning over 16%, and pushing valuations to levels not seen since the tech bubble. Market momentum has been further fuelled by an astounding number of companies going public, with initial public offering (IPO) activity at its highest level in two decades. Many of these unicorn companies—those going public with multi-billion-dollar valuations—such as Airbnb and DoorDash, both of which are still losing money, saw their prices soar more than 80% in the week they launched. Investors similarly have been hot to jump into special purpose acquisition companies (SPACs), or 'blank cheque' companies, that pool together investors' money through an IPO before deciding what to invest in. Cryptocurrencies have also garnered significant interest this year, further fueling the speculative enthusiasm. Going into 2021, investors don't seem fazed that these signs of excess could be foreshadowing a replay of 2000, and companies seeking to go public don't appear to be slowing down anytime soon.

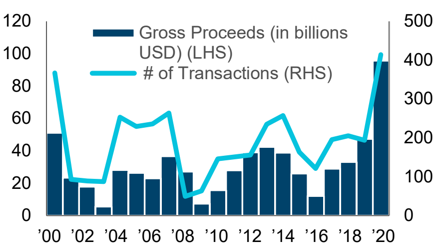
Inflation, for real?

After more than a decade of Fed policy geared towards stimulating growth and higher inflation, could the recovery from the coronavirus finally be the catalyst for higher prices? The market seems to be betting that it could, with breakeven rates—the yield difference between nominal and inflation-linked Treasuries—nearing the 2% level. With high expectations for unleashed pent-up demand on the way, supply will have to play catch-up in the second half of 2021, likely pushing inflation higher. One key component of the consumer price index—shelter prices—has already received a boost as the coronavirus has unexpectedly fueled a housing boom. Back in August, the Fed unveiled a new approach, allowing inflation to 'average' 2% over time, with an emphasis on sustained growth. Given the new policy, inflation expectations may be allowed to move higher into 2021 with markets less fearful of the Fed. With the Fed remaining anchored and with higher inflation, real yields could be pushed even lower.

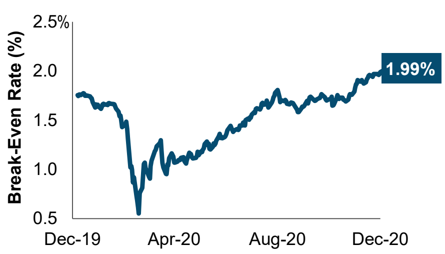
Suga High

Investors have newfound interest in Japan as evident in strong flows, the Nikkei 225 Index reaching a 30-year high and optimism surrounding the election of new Prime Minister Yoshihide Suga last September. Suga, while dealing with the impacts of the coronavirus, has promised to remain focused on his predecessor's structural reform policies—known as 'Abenomics'—that have driven shareholder-friendly initiatives, including an acceleration in share buybacks. He additionally created a new digital agency focused on the need to improve productivity, a problem that still plagues the government and many companies, even though Japan is known as a powerhouse of technical innovation in areas such as semiconductors and robotics. While cheering these structural reforms, investors also see the opportunity for Japan's heavily export-oriented sectors to benefit as global economies reemerge from lockdowns this year. With these cyclical and secular forces helping to drive growth, there may be more to cheer about in Japan this summer than just the Olympic games.

US IPO Activity
As of 31 December 2020



US 10-Year Break-Even Rate
As of 31 December 2020



Nikkei 225 Index
As of 31 December 2020

Past performance is not a reliable indicator of future performance.

Sources: Nikkei, Bloomberg Finance L.P., and T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. See Additional Disclosures.

	Positives	Negatives
Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Monetary and fiscal policy remain accommodative ▪ Equity valuations remain attractive ▪ Stronger long-term euro outlook	▪ New lockdowns amid second wave of coronavirus ▪ Elongated process to enact further stimulus ▪ Brexit likely to negatively impact trade ▪ Less scope for European Central Bank to stimulate further ▪ Limited long-term catalysts for growth
United Kingdom	▪ Vaccine news means that the heavily services-based UK economy is seeing a light at the end of the tunnel ▪ An exuberant housing market, driven by stamp duty cuts and pent-up demand, will support consumption for now	▪ Longer-term restrictions imposed on exit from second national lockdown will be impactful ▪ Transition to new trade arrangements will be very economically disruptive ▪ Projections forecast an 11.5% of gross domestic product structural fiscal tightening for 2021 ▪ Combination of these risks make a move to negative rates more likely, weighing on sterling
United States	▪ More fiscal support on the way ▪ Monetary policy remains very accommodative ▪ Healthy consumer balance sheets and high savings rate ▪ Low rates driving strong housing market	▪ Increasing COVID-19 cases ▪ Expensive stock and bond valuations ▪ Elevated corporate and government debt levels ▪ US dollar weakness

	Positives	Negatives
Japan	▪ The economy continues to heal at a slow pace with further stimulus measures announced ▪ Despite reaching multi-decade highs, equity markets remain reasonably valued relative to peers and could benefit from a global recovery ▪ While current recovery will be centred on traditional industries like automakers, Japan Inc. is changing with a push towards digitalisation and governance	▪ The economic recovery has been slower than in other developed economies, while a new wave of COVID-19 cases has raised expectations for a state of emergency declaration ▪ Equity markets reaching new highs might lead to some profit-taking in the near term ▪ Market indicators signal a stronger yen, which would reduce companies' competitiveness and profitability
Asia Pacific ex-Japan	▪ Positive economic growth momentum in China should continue well into 2021, with a clear focus on domestic consumption ▪ We expect the renminbi to remain strong and Chinese bonds to stay attractive given the global low-yield environment and that they have become more accessible to foreign investors ▪ Australian consumer spending should continue to be supported by pent-up demand and an improving job market ▪ The Australian economy could outperform in the near term after effectively containing a COVID-19 outbreak. Earnings forecasts also seem to underestimate speed of recovery	▪ Chinese economic momentum seems to be peaking, while a tightening of policies is possible in the second half ▪ Tech dominance in the Chinese equity markets may be a headwind in the face of new regulations and high valuations ▪ Risk exists that Australian support measures could be wound down too quickly, creating a hangover effect if the fiscal tap is turned off ▪ A strong Australian dollar might be the target of future measures from the central bank
Emerging Markets	▪ Chinese economy has largely rebounded ▪ US dollar weakness ▪ Exposure to cyclical areas of the economy should benefit from broad global recovery ▪ Equity valuations attractive relative to developed markets	▪ Limited ability to enact fiscal stimulus (excluding China) ▪ Capacity and infrastructure to combat COVID-19 vary ▪ Stimulus from China likely to fade going forward

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 December 2020

Underweight — *Neutral* — *Overweight*   ▼ or ▲ Month-Over-Month Change

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

		Change	Underweight		Neutral	Overweight		
ASSET CLASSES	Equities				■			Elevated valuations are reflecting optimistic recovery outlook, with earnings likely to improve significantly. Timing of vaccine distribution and forthcoming fiscal stimulus will be key drivers.
	Bonds				■			Short-term yields remain anchored amid central bank pledges of support. Longer rates likely to continue moving higher on improving growth and hints of inflation.
	Region							
EQUITIES	US			■				Defensive, growth-oriented profile less supportive as cyclical sectors should benefit from improving 2021 outlook. US dollar weakness could be an additional headwind.
	Europe ex-UK	▼		■				Cyclically oriented sector profile and low valuations among financials are supportive. However, long-term catalysts are scarce, and coronavirus outbreaks remain problematic.
	UK				■			After underperforming other equity markets in 2020, price level is compelling. Bank of England and fiscal stimulus are supportive.
	Japan	▲				■		Improving global trade outlook is a key driver. Refocus on reform efforts remains an important catalyst for improving productivity and attracting foreign capital.
	Developed Asia ex-Japan*				■			Valuations attractive relative to the US. Chinese stimulus and successful containment of the coronavirus are supportive. Export and commodity-driven economies face challenges.
	Emerging Markets					■		Exposure to global trade and favourable currency trends offer strong tailwinds. Within EM, we favour cyclical sectors (financials and industrials) and regions (Latin America and EMEA).
	Style							
	Global Equity Growth			■				Vulnerability to extended valuations, narrow leadership and improving economic growth outlook could drive rotation towards cyclicals. Earnings trends may become more challenging.
	Global Equity Value					■		Cyclical orientation could benefit from pent-up demand, economic improvement, higher rates and fiscal stimulus. Valuations have increased but remain attractive on a relative basis.
	Capitalisation							
	Global Equity Large-Cap			■				Larger companies face challenging valuations, particularly in tech, and could lag as recovery advances.
	Global Equity Small-Cap					■		Smaller firms should benefit most from unleashed pent-up demand and fiscal stimulus. Valuations are less challenging than large-caps and continue to offer potential upside to recovery.

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* Includes Australia.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 December 2020

Underweight — *Neutral* — *Overweight* | ▼ or ▲ Month-Over-Month Change

		Change	Underweight	Underweight	Neutral	Overweight	Overweight	These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
FIXED INCOME	Euro Government Bonds			■				Yields remain near record lows as the ECB is willing to further support the eurozone's recovery, but they are vulnerable to steepening at the long end should growth expectations improve.
FIXED INCOME	Euro Inflation Linked				■			Inflation expectations remain low amid slightly improving growth outlook. The European Central Bank remains supportive.
FIXED INCOME	Euro IG Corporates				■			Supportive technicals and digestible supply, alongside positive vaccine news, have allowed the market to look through weak fundamentals and squeeze valuations.
FIXED INCOME	US IG Aggregate			■				Nominal Treasury yields remain at low levels, and potential for improving growth and additional fiscal stimulus could place upward pressure on yields.
FIXED INCOME	Global High Yield					■		Spreads have contracted to fair value levels, but yields are still attractive versus IG bonds. Fundamentals are broadly supportive, but potential for downgrades and defaults in select sectors.
FIXED INCOME	EM Dollar Sovereigns				■			Sector offers attractive yield versus developed markets, but relative valuations are less attractive after rally. Concerns around capacity for additional fiscal support remain.
FIXED INCOME	EM Local Currency					■		Valuations remain attractive with continued accommodative monetary policy and potential for weaker US dollar.
FIXED INCOME	EM Corporates				■			The impact of the pandemic on the asset class is difficult to quantify, but the prospect of normalisation bodes well. Country-specific risks remain elevated.
CURRENCIES	EUR vs. USD				■			We continue to expect some weakness in the euro near term, weighed down by growth weakness in Q1 2021. We retain a bias to the upside for the currency over the medium term.
CURRENCIES	EUR vs. JPY			■				The outlook for the yen is positive, reflecting a supportive environment for investment flows and cheap valuations.

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EUROPEAN INVESTMENT COMMITTEE

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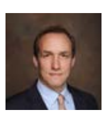

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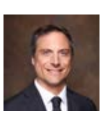

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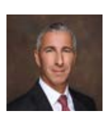

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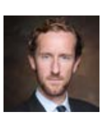

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