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INVEST WITH CONFIDENCE

Global Asset Allocation: The View From Europe

May 2021

1 Market Perspective

As of 30 April 2021

- Global economic growth is expected to begin peaking in the coming quarters as the impacts of economic reopening and fiscal stimulus are realised.
- Global inflation expectations are likely to trend higher as the consumer demand surge is met with signs of supply shortages and as the Fed promises to keep a zero interest rate policy until the labour market rebounds.
- Asian and European economies should benefit amid the recovery given their higher cyclical exposures, although recent resurgence in coronavirus cases in major Asian economies is a growing concern.
- Key risks to global markets include the resurgence in coronavirus cases, pace of vaccinations, rising inflation, geopolitical concerns, and potential for higher taxes as countries pivot to funding recovery costs.

2 Portfolio Positioning

- We increased our underweight in equities relative to bonds and cash as the risk/reward profile looks less compelling for equities after a strong rebound from March 2020 lows. Equities could be vulnerable to potential setbacks in the recovery, fading policy support and higher taxes.
- We increased the overweight of euro versus the US dollar. The recent dollar weakness should continue as the US policy stance remains very loose and the European re-opening accelerates in the spring. Europe is also a major beneficiary of the current global manufacturing boom.
- Within equities, we are further tilting into value globally, based on more attractive relative valuations and expectations for cyclical companies to continue to benefit from the improvement in growth from a recovering global economy—bolstered by fiscal stimulus in the US, increasing commodity prices and higher interest rates.

3 Market Themes

Surprise

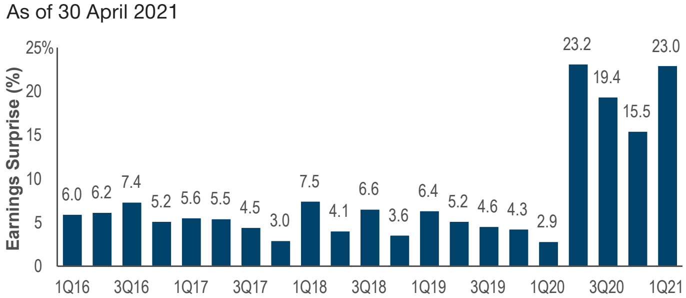
As first-quarter earnings season comes to an end, the biggest surprise has been the 'surprises' themselves, in terms of how much companies have beat earnings expectations. First-quarter expectations were for a near-20% increase in S&P 500 earnings, but companies have blown past that estimate, approaching a 45% year-over-year gain. Ironically, this was not the first quarter for massive surprises as companies have significantly exceeded expectations throughout most of the pandemic, particularly as many technology companies benefited exponentially early on from the lockdowns. The surprises this quarter, however, have been led by more cyclical companies in the energy and consumer discretionary sectors. While seemingly all positive news, price reaction to earnings beats was muted this quarter, suggesting investors may be rationalising high valuations with a normalisation in future earnings or perhaps the mounting pressure from rising input costs.

Crosscurrents

A renewed surge in coronavirus cases across several emerging markets (EM) countries—including India, Brazil, and Argentina—is weighing heavily on these economies as they struggle with insufficient medical infrastructure and access to vaccines. In addition, higher interest rates, rising inflation, a strengthening US dollar, and moderating growth in China have investors concerned about emerging markets prospects. EM have lagged developed markets (DM) year-to-date and with much of the economic recovery appearing priced into many DMs emerging markets may have more room to advance as the global recovery takes hold. With commodity prices still on the rise, expectations for a weaker US dollar, and a continued dovish stance from the Fed, we think emerging markets may be in a strong position to rebound—assuming that they can navigate the crosscurrents.

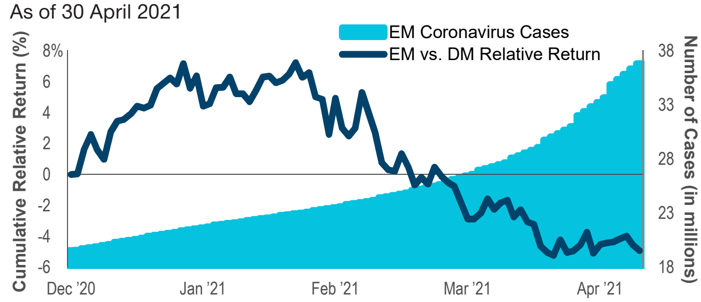
S&P 500 Earnings Surprises[1]

As of 30 April 2021



EM vs. DM Relative Return & EM Coronavirus Cases[2]

As of 30 April 2021



Past performance is not a reliable indicator of future performance.

[1] Earnings surprises represent the aggregate percentage that S&P 500 reported quarterly earnings, which have exceeded expectations as of the close of the quarter.

[2] EM coronavirus cases represented by cases in India, Brazil and Argentina. EM vs. DM relative return represented by MSCI Emerging Markets Index and MSCI World Index, respectively.

Sources: Standard & Poor's, MSCI, and T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved. (See Additional Disclosures.)

REGIONAL BACKDROP

As of 30 April 2021

	Positives	Negatives
Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Lockdowns are being lifted in most countries ▪ Monetary and fiscal policies remain accommodative ▪ Equity valuations remain attractive relative to the US ▪ Stronger long-term euro outlook	▪ Vaccination effort facing supply shortages ▪ Limited long-term catalysts for growth ▪ Limited scope for European Central Bank (ECB) to stimulate further ▪ Brexit likely to negatively impact trade
United Kingdom	▪ Rapid vaccination means that the economy could return closer to normal by autumn, two to three months ahead of eurozone countries ▪ Lockdown exit strategy is now firmly in place ▪ Fiscal furlough extension and investment tax super deduction to support strong recovery ▪ A Brexit deal has been achieved	▪ Brexit transition and third lockdown could slow down the pace of economic recovery ▪ Demand risks from a delayed, but likely very large, fiscal consolidation in two to three years remain ▪ The Bank of England remains very hawkish in light of strong real economy data ▪ Overheating housing market could pose future financial stability risk
United States	▪ Pace of vaccinations has been strong ▪ Monetary policy remains very accommodative ▪ More fiscal support on the way ▪ Healthy consumer balance sheets and high savings rate	▪ Elevated stock and bond valuations ▪ High corporate and government debt levels ▪ Corporate taxes likely to rise ▪ Unemployment remains elevated

	Positives	Negatives
Japan	▪ Leading economic indicators are breaking through the expansion levels. Employment and retail sales data are surprising on the upside ▪ Domestic stocks are a global reflation play, with positive correlations to Purchasing Managers' Indices and bond yields ▪ Earnings revision ratios are close to record levels	▪ Price momentum in equity markets is calling for a pause in the appreciation trend in the near term ▪ COVID-19 vaccines are being administered late relative to other countries, while the pandemic is still not yet under control ▪ Bank of Japan dropped the annual exchange-traded fund buying target, causing some concerns regarding its ability to remain the buyer of last resort
Asia Pacific ex-Japan	▪ Chinese economic growth remains solid, with domestic consumption progressively replacing industrial production as the main driver ▪ Policy targets in China (e.g., growth and fiscal deficit) allow for some flexibility on the path to normalisation ▪ Economic data in Australia, such as business conditions and companies' profitability, continue to beat multi-decade records ▪ The Reserve Bank of Australia remains extremely dovish, indicating any policy organisation may be a long way off	▪ Early signs of inflationary pressures and supply bottlenecks in China are concerning; economic momentum may have peaked in Q1 ▪ Chinese policymakers' focus on deleveraging the economy creates some concerns for certain companies, although this is not a systemic risk ▪ Slow COVID-19 vaccine rollout is a concern in Australia as the winter season approaches ▪ Early signs of inflationary pressures seen in Australian housing and construction markets
Emerging Markets	▪ Exposure to cyclical areas of the economy should benefit from broad global recovery ▪ Commodity prices rising ▪ Chinese economy remains strong ▪ Equity valuations attractive relative to developed markets	▪ Very concerning coronavirus outbreak in India ▪ Vaccine supply and distribution infrastructure are well behind developed markets ▪ Stimulus from China likely to fade going forward ▪ Limited ability to enact fiscal stimulus (excluding China)

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EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 30 April 2021

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.**
ASSET CLASSES	Equities			■				Economic and earnings growth supportive, but elevated valuations could be vulnerable to potential setbacks in recovery, higher rates, fading policy support, and tax increases.
	Bonds					■		Bonds remain vulnerable to rising inflation expectations and growth trajectory. Positive economic backdrop should continue to support credit sectors, but high valuations limit upside.
	Region							
EQUITIES	US			■				Valuations reflect economic and earnings rebound. Rising rates and taxes could be headwinds. Cyclical sectors should benefit from improving macro backdrop.
	Europe ex-UK			■				Cyclically oriented sector profile and low valuations among financials are supportive. However, long-term catalysts are scarce, and concerns remain around vaccine rollout.
	UK					■		Continued vaccination pace is likely to lead to easing lockdown and strong real activity.
	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 virus are supportive. Export and commodity-driven economies face challenges.
	Emerging Markets					■		Exposure to global trade and rising commodity prices offer strong tailwinds. However, fading Chinese stimulus and mutation-driven outbreak in India pose challenges.
	Style and Market Capitalisation							
	Global Growth vs. Value[1]			■				Cyclical orientation of value stocks, attractive valuations and rising rates could further the rotation out of growth. Vaccine supply constraints and outbreak in India are sources of uncertainty.
	Global Small- vs. Large-Cap[1]					■		Early-cycle exposure remains supportive for small-caps, and idiosyncratic opportunities are plentiful. Meanwhile, steeper yield curve and improving economic outlook should benefit large-caps.

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*Includes Australia.

[1] For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 30 April 2021

Underweight — *Neutral* — *Overweight*

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FIXED INCOME	Euro Government Bonds	■					Europe is turning the COVID-19 corner. Manufacturing PMIs are at record highs and services activity is likely to pick up as European countries gradually open up.
	Euro Inflation Linked				■		While inflation expectations are on the rise, actual inflation can surprise on the upside.
	Euro IG Corporates			■			Technicals remain supportive, but there are still plenty of uncertainties around corporate fundamentals. Little value at current spreads, though ECB buying remains supportive.
	US IG Aggregate		■				Scope for rates in Europe to rise more than in the US. However, stronger inflation and economic growth are expected in the latter.
	Global High Yield				■		Limited upside potential from elevated valuations; relative yields still attractive versus fixed income alternatives. Fundamentals supportive on improving growth and commodity rebound.
	EM Dollar Sovereigns			■			Sector offers attractive yield versus developed markets. However, vulnerabilities across countries vary given coronavirus spread, rising inflation, and susceptibility to rising rates.
	EM Local Currency				■		Valuations remain modestly attractive; improving macro backdrop and weaker US dollar could provide tailwinds. Higher US rates and EM central bank rate hikes could be a headwind.
	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				■		Recent dollar weakness should continue as US policy stance remains loose and Europe's reopening accelerates. Europe is also a beneficiary of the current global manufacturing boom.
	EUR vs. JPY		■				The yen remains a safe-haven currency.

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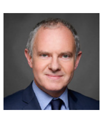
EUROPEAN INVESTMENT COMMITTEE



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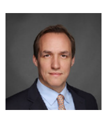

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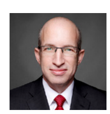

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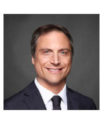

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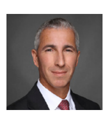

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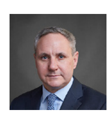

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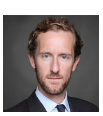

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