



# Global Asset Allocation: The View From the UK

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, European and British economies should benefit amid the recovery given their higher cyclical exposures, although the recent resurgence in coronavirus cases in major Asian economies is a growing concern.
- Key risks to global markets include the resurgence in coronavirus cases, the pace of vaccinations, rising inflation, geopolitical concerns, and the 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 closed our underweight in the euro versus the British pound because most of the good news for the pound is already priced in, while we also expect euro strength on the horizon.
- 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.

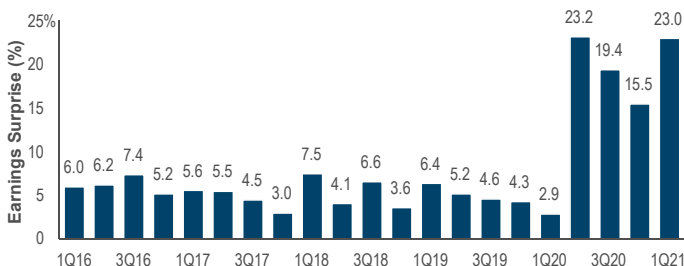
## 3 Market Themes

### 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 benefitted 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.

### S&P 500 Earnings Surprises<sup>1</sup>

As of 30 April 2021



### Past performance is not a reliable indicator of future performance.

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

<sup>2</sup> 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.

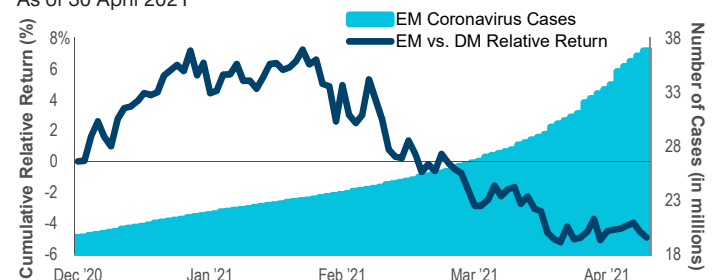
Sources: Standard & Poor's, MSCI and T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved. (See Additional Disclosures.)

### Crosscurrents

A renewed surge in coronavirus cases across several emerging markets (EMs) 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. EMs have lagged developed markets (DMs) 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.

### EM vs. DM Relative Return & EM Coronavirus Cases<sup>2</sup>

As of 30 April 2021





 **Positives**

 **Negatives**

**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

**Developed 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 the European Central Bank (ECB) to stimulate further
- Brexit likely to negatively impact trade

**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

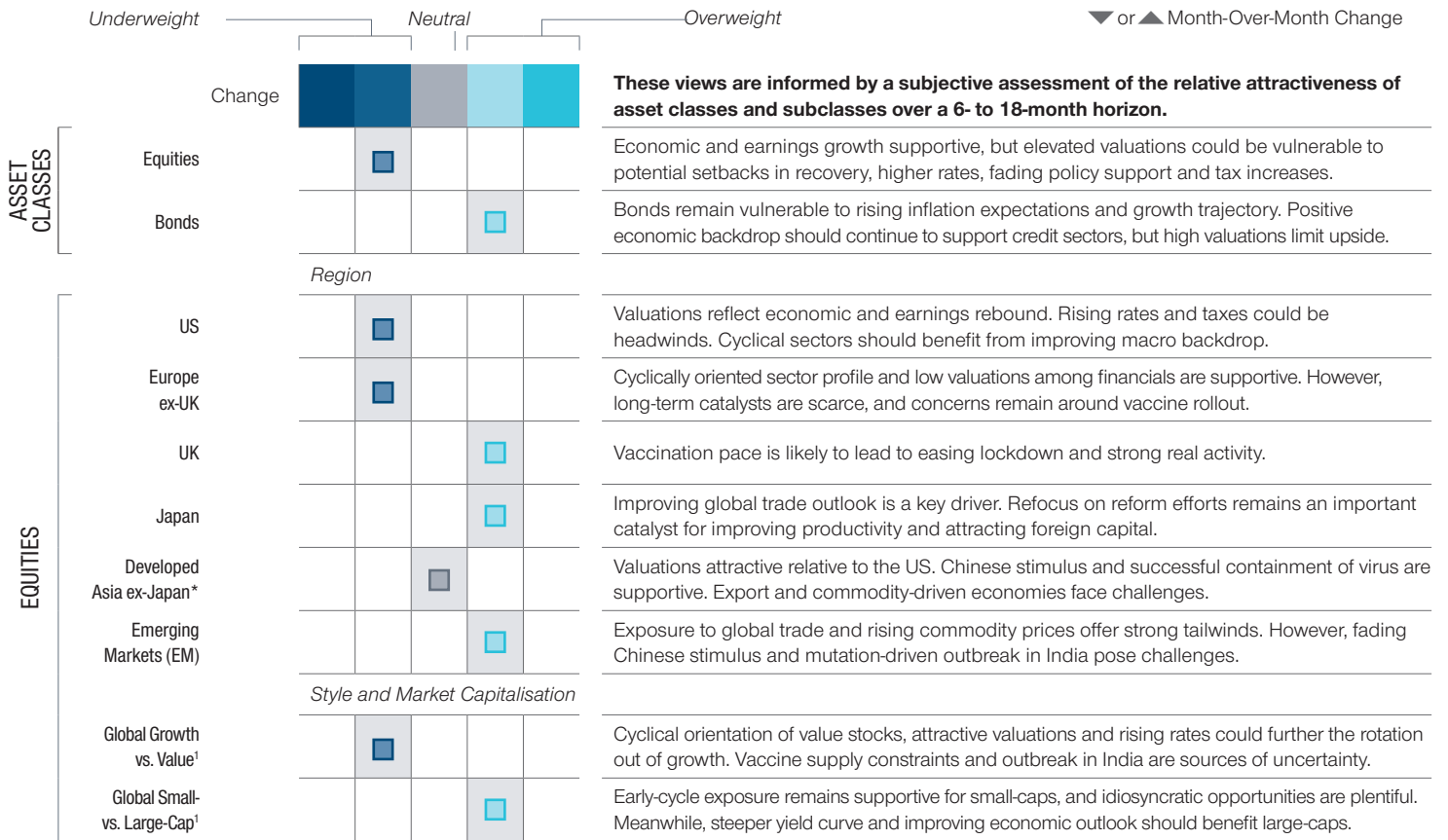
 **Positives** **Negatives**

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| <b>Japan</b> | <ul style="list-style-type: none"><li>▪ Leading economic indicators are breaking through the expansion levels. Employment and retail sales data are surprising on the upside</li><li>▪ Domestic stocks are a global reflation play, with positive correlations to purchasing managers' indices and bond yields</li><li>▪ Earnings revision ratios are close to record levels</li></ul> | <ul style="list-style-type: none"><li>▪ Price momentum in equity markets is calling for a pause in the appreciation trend in the near term</li><li>▪ COVID-19 vaccines are being administered late relative to other countries, while the pandemic is still not yet under control</li><li>▪ The Bank of Japan dropped the annual exchange-traded fund buying target, causing some concerns regarding its ability to remain the buyer of last resort</li></ul> |
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| <b>Asia Pacific<br/>ex-Japan</b> | <ul style="list-style-type: none"><li>▪ Chinese economic growth remains solid, with domestic consumption progressively replacing industrial production as the main driver</li><li>▪ Policy targets in China (e.g., growth and fiscal deficit) allow for some flexibility on the path to normalisation</li><li>▪ Economic data in Australia, such as business conditions and companies' profitability, continue to beat multi-decade records</li><li>▪ The Reserve Bank of Australia remains extremely dovish, indicating any policy organisation may be a long way off</li></ul> | <ul style="list-style-type: none"><li>▪ Early signs of inflationary pressures and supply bottlenecks in China are concerning; economic momentum may have peaked in Q1</li><li>▪ Chinese policymakers' focus on deleveraging the economy creates some concerns for certain companies, although this is not a systemic risk</li><li>▪ Slow COVID-19 vaccine rollout is a concern in Australia as the winter season approaches</li><li>▪ Early signs of inflationary pressures seen in Australian housing and construction markets</li></ul> |
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| <b>Emerging<br/>Markets</b> | <ul style="list-style-type: none"><li>▪ Exposure to cyclical areas of the economy should benefit from broad global recovery</li><li>▪ Commodity prices rising</li><li>▪ Chinese economy remains strong</li><li>▪ Equity valuations attractive relative to developed markets</li></ul> | <ul style="list-style-type: none"><li>▪ Very concerning coronavirus outbreak in India</li><li>▪ Vaccine supply and distribution infrastructure are well behind developed markets</li><li>▪ Stimulus from China likely to fade going forward</li><li>▪ Limited ability to enact fiscal stimulus (excluding China)</li></ul> |
|-----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

**Past performance is not a reliable indicator of future performance.**



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\* Includes Australia.

<sup>1</sup> 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.



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## UK INVESTMENT COMMITTEE



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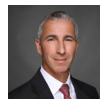
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