Global Asset Allocation: The View From Europe

July 2021

As of 30 June 2021

1 Market Perspective

- Global economic growth to remain strong through the back half of the year, albeit off peak levels, as monetary and fiscal policy support moderates from crisis-level highs.
- Longer-term interest rates likely challenged to move higher as growth moderates, inflation softens from recent peaks and Federal Reserve moves closer to tapering asset purchases, while short-term rates could begin to price in tighter policy leading to a flattening yield curve.
- While still supportive, global monetary policy should continue to see a gradual trend towards tightening among central banks, notably within emerging markets (EM), facing rising inflation.
- Key risks to global markets include the path forward for the coronavirus, elevated inflation, central bank missteps, higher taxes, stricter regulatory environment and increasing geopolitical concerns.

2 Portfolio Positioning

- We remain modestly underweight equities relative to bonds and cash as the risk/reward profile looks less compelling for equities and could be vulnerable to fading policy support, increased rate volatility, high inflation levels and potential tax increases.
- Within equities, we continue to favour value-oriented equities globally, US small-caps and EM stocks as we expect cyclically exposed companies to continue to benefit from strong economic growth and global reopening.
- Within fixed income, we continue to have a bias towards shorter-duration, higher-yielding and inflation-sensitive sectors through overweights to high yield bonds, emerging market debt local currency and corporates and inflation-linked government bonds.

3 Market Themes

Easy on the Austerity

Following a shaky start to its vaccine rollout, Europe appears to be recovering as businesses are reopening and lockdowns continue to ease in some areas. As the European Central Bank debates the extension of its EUR 1.85 trillion asset purchase programme, due to expire next March, additional fiscal stimulus is being rolled out through the unprecedented European Union recovery fund, worth up to EUR 800 billion. While the fund shows signs of growing unity among member nations, lines are being drawn once again as members take sides on scaling back monetary policies put in place amid the pandemic. Leaders such as Mario Draghi, Italy’s prime minister, warn that shifting back to austerity too soon could ignite another decade-long recovery similar to the post-global financial crisis period. With Europe already lagging the US and China, shifting back to austerity too soon could prevent the region from heading on a path towards more sustainable growth.

Curbing Our Enthusiasm

Global equity markets represented by the MSCI All Country World Index have returned nearly 12% year-to-date in US dollar terms amid signs that the worst of the pandemic may finally be behind us. But, as supportive trends that have fueled the global economic growth rebound start to fade, it’s hard to envision equity markets expanding at the same record pace. In the back half of the year, we expect that growth will be off peak levels, monetary policy will continue to tighten, fiscal stimulus will be at lower levels and higher taxes are likely. Adding to these headwinds, equity markets are sitting at elevated valuations supported by low interest rates, input costs are rising and earnings growth is expected to moderate next year. Despite these trends, equities remain attractive as pent-up demand continues to be unleashed and, while moderating, growth remains elevated. However, the ultra-easy environment is changing quickly and may lead to more volatility ahead, so investors may need to curb their enthusiasm for equity returns going forward.

Euro Area GDP

As of 30 June 2021

Global Equity Index Returns1,2

As of 30 June 2021

Past performance is not a reliable indicator of future performance.

1 Global Equity Index is represented by MSCI All Country World Index (see Additional Disclosure). Total return in US dollars.
2 Source: FactSet. Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved.
Sources: Haver Analytics, Bureau of Labor Statistics, IMF.
## REGIONAL BACKDROP

**Positives**

**Europe**
- Higher exposure to more cyclically oriented sectors that should benefit from economic recovery
- Pace of vaccinations has significantly improved
- Monetary and fiscal policy remains accommodative
- Equity valuations remain attractive relative to the US

**Negatives**
- Limited long-term catalysts for growth
- Limited scope for European Central Bank to stimulate further
- Brexit likely to negatively impact trade
- Potential for new coronavirus variants to cause continued outbreaks

**United Kingdom**
- Best vaccination progress in Europe, and vaccine hesitancy remains low
- Investment tax super deduction to support strong recovery
- All social distancing restrictions dropped—services will excel
- Brexit deal achieved

**Negatives**
- Large rise of the delta variant could make consumers cautious until current COVID-19 wave subsides
- Demand risks from a delayed, but likely very large, fiscal consolidation in two to three years remain
- Bank of England to remain very hawkish in light of strong real economy data
- Overheating housing market could pose future financial stability risk

**United States**
- Vaccinations widely distributed, case count near lows
- Infrastructure spending bill likely to be passed
- Healthy consumer balance sheets and high savings rate
- Strong earnings expectations

**Negatives**
- Elevated stock and bond valuations
- High corporate and government debt levels
- Fed dovishness has peaked
- Corporate taxes likely to rise
<table>
<thead>
<tr>
<th>Positives</th>
<th>Negatives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Japan</strong></td>
<td><strong>Negatives</strong></td>
</tr>
<tr>
<td>Economic data are slowly improving, especially in services and consumer-related sectors</td>
<td>Valuation derating remains a headwind despite strong earnings growth</td>
</tr>
<tr>
<td>Domestic stocks are overdue to catch up with the global reflation play</td>
<td>Capital spending outside of information technology is disappointing and could be a risk for future earnings growth</td>
</tr>
<tr>
<td>Policy setting remains extremely accommodative, with unspent fiscal funds expected to offer further boost to the economic recovery</td>
<td></td>
</tr>
<tr>
<td><strong>Asia Pacific ex-Japan</strong></td>
<td></td>
</tr>
<tr>
<td>Chinese economic growth remains solid, but domestic drivers now need to contribute more. An impressive vaccination pace should remove uncertainties related to local outbreaks</td>
<td>Consumer spending in China is still lagging the recovery and below expectations. Local COVID-19 outbreaks don’t help sentiment</td>
</tr>
<tr>
<td>Chinese equity consolidation looks overdone on the back of supportive flow dynamics and clarification on tech regulations</td>
<td>Early signs of inflationary pressures seen in the Australian housing and construction markets. There have been mentions of a housing bubble in some reports</td>
</tr>
<tr>
<td>Economic data in Australia continue to roar, boosted by strong commodity prices and construction-related activities</td>
<td>The Reserve Bank of Australia might change its policy guidance abruptly as it upgrades the economic forecasts. Beware of a U-turn for financial conditions</td>
</tr>
<tr>
<td>Australian business capex expected to rebound to support future earnings growth</td>
<td></td>
</tr>
<tr>
<td><strong>Emerging Markets</strong></td>
<td></td>
</tr>
<tr>
<td>Exposure to cyclical areas of the economy should benefit from a broad global recovery</td>
<td>Vaccine supply and distribution infrastructure are well behind developed markets (excluding China)</td>
</tr>
<tr>
<td>Commodity prices are elevated</td>
<td>Stimulus from China is fading</td>
</tr>
<tr>
<td>Chinese economy remains strong</td>
<td>Limited ability to enact fiscal stimulus (excluding China)</td>
</tr>
<tr>
<td>Equity valuations attractive relative to developed markets</td>
<td></td>
</tr>
</tbody>
</table>

Past performance is not a reliable indicator of future performance.
These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.

While peaking, growth remains supportive; however, elevated valuations leave little room for upside. Equities could also be vulnerable to fading policy support, coronavirus challenges, input cost inflation, tax increases and higher rates.

Yields are rangebound as they face countervailing forces of higher inflation versus past peak growth and tightening global central bank policies. Solid fundamentals but upside limited for credit sectors.

Elevated valuations reflecting strong recovery and earnings rebound. Rising rates and taxes could be headwinds. Cyclical sectors should continue to benefit from strong macro backdrop, but a lot of good news is already priced in.

Cyclically oriented sector profile, low valuations among financials, fiscal support and improving vaccination rate supportive. However, long-term catalysts for sustained growth are scarce.

Continued vaccination pace is likely to lead to easing lockdown and strong real activity.

Despite year-to-date weakness and challenges in vaccine rollout, cyclical exposure should be supportive along with attractive valuations and improving global trade outlook.

Valuations attractive relative to the US, Chinese stimulus and successful containment of virus are supportive. Export and commodity-driven economies face challenges.

Exposure to global trade and elevated commodity prices offer strong tailwinds. However, fading Chinese stimulus, potential Fed tapering and vaccine distribution challenges remain concerns.

Deep cyclical orientation of value stocks combined with attractive relative valuations and rising rates could be catalysts for further rotation out of growth. Vaccine supply constraints and the outbreak in India are sources of uncertainty.

Early-cycle exposure remains supportive for small-caps, and idiosyncratic opportunities are plentiful. Meanwhile, steeper yield curve and improving global economic outlook should benefit large-caps given cyclical orientation and exposure to international trade.

Past performance is not a reliable indicator of future performance.

* 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.
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**: Underweight
- **Euro Inflation Linked**: Neutral
- **Euro IG Corporates**: Overweight
- **US IG Aggregate**: Neutral
- **Global High Yield**: Underweight
- **EM Dollar Sovereigns**: Neutral
- **EM Local Currency**: Overweight
- **EM Corporates**: Overweight

**Currencies**

- **EUR vs. USD**: Neutral
- **EUR vs. JPY**: Underweight

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

The specific securities identified and described are for informational purposes only and do not represent recommendations.
INVEST WITH CONFIDENCE™

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

Additional Disclosure

Source: MSCI. MSCI and its affiliates and third party sources and providers (collectively, "MSCI") makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. Historical MSCI data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Important Information

This material is being furnished for general informational and/or marketing purposes only. This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources’ accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

© 2021 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.