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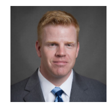
Asset Allocation Insights

A Long-Awaited Reversal

February 2023



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KEY INSIGHTS

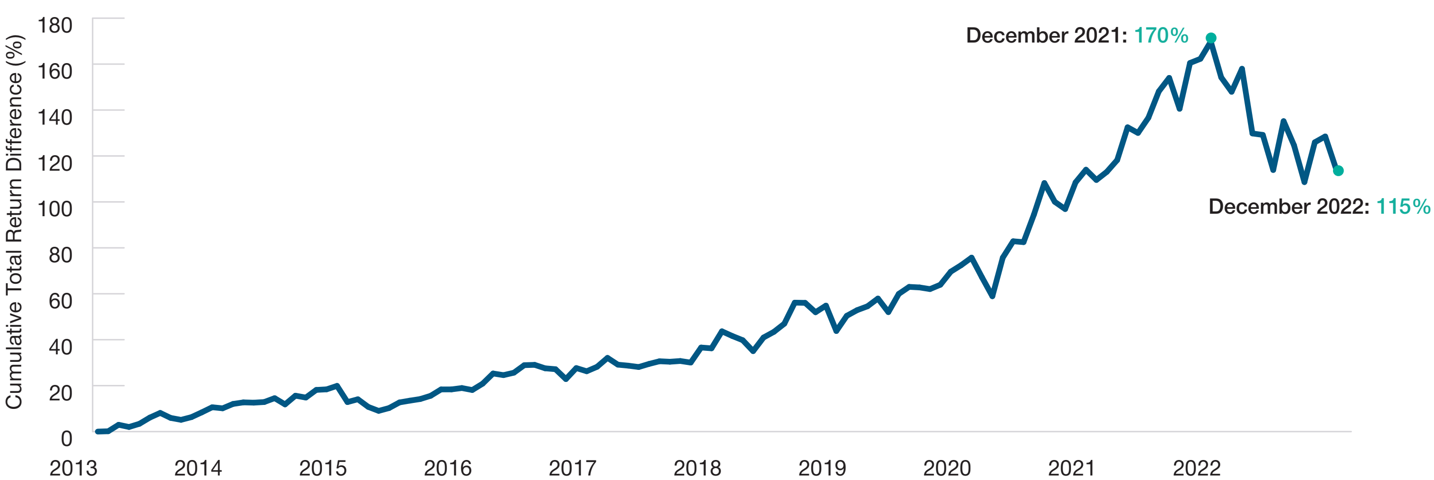
- After nearly a decade of outperformance, U.S. equities trailed the rest of the world in 2022, and many wonder if this shift in performance will continue in 2023.
- In our view, improved economic outlooks in China and Europe, coupled with a weaker U.S. dollar, may favor international markets in the near term.

For the nine years from 2013 through 2021, MSCI indices show that U.S. equities outpaced the rest of the world by 170%, cumulatively. However, the cumulative U.S. equity outperformance significantly narrowed in 2022 to 115% (Figure 1). Many investors are wondering what has driven this shift and if the trend is likely to continue in 2023.

Notably, improved economic outlooks in China and Europe appear to favor non-U.S. equites. After the recent relaxation of COVID-related restrictions

U.S. Equity Performance Versus the Rest of the World

(Fig. 1) Index performance: MSCI U.S. Index versus MSCI All Country World Index ex-U.S. (in local currency)



January 31, 2013 through December 31, 2022.
Past performance is not a reliable indicator of future performance.
Sources: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. MSCI data. See Additional Disclosures.

in China, we believe economic activity there is poised to increase significantly in 2023. Increased credit use by Chinese borrowers—which historically has had a strong lagged effect on the country's economy—is also likely to boost reported activity.

In Europe, natural gas supply disruptions caused by Russia's invasion of Ukraine were expected to cause widespread power shortages and significantly curtail economic activity during the winter. However, relatively warm weather, coupled with imports of liquefied natural gas, allowed storage levels to rebound to nearly full levels by year-end. So far, industrial activity in Europe has largely remained unaffected, and the region's near-term growth outlook has improved considerably. An expected recovery in demand from China should also be beneficial.

Meanwhile, the strong U.S. dollar has begun to fade—a weaker dollar is typically supportive for non-U.S. stocks as it tends to increase the dollar value of dividends earned in foreign currencies. We believe the dollar is likely to weaken further as interest rate differentials narrow, reflecting a potential dovish shift in U.S. Federal Reserve policy relative to other major central banks. Improved economic outlooks in China and Europe could also narrow regional economic growth differentials, further weighing on the dollar.

The year 2022 brought a notable shift in performance for global equities. In our view, improved outlooks in China and Europe, coupled with a weaker U.S. dollar, should be tailwinds for non-U.S. equity markets in the near term. As a result, T. Rowe Price's Asset Allocation Committee is maintaining an overweight position in non-U.S. equities relative to U.S. equities.

A Weaker U.S. Dollar

(Fig. 2) U.S. Dollar Index

10 years ended January 23, 2023.

Past performance is not a reliable indicator of future performance.

Source: Bloomberg Finance L.P.

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