T. Rowe Price®
INVEST WITH CONFIDENCE

Global Asset Allocation: The View From Europe

June 2023

1 Market Perspective

- The macroeconomic outlook remains mixed as data have been surprising to the upside, despite evidence of tightening financial conditions that are still expected to weigh on economic growth in the back half of the year.
- Global central banks are approaching peak tightening in the face of lower inflation, with the Federal Reserve (Fed) closer to pausing as it moves to data dependency, while the European Central Bank (ECB) and Bank of England remain on course as inflation remains stickier. Meanwhile, expectations for the Bank of Japan shifting yield curve control policy have been pushed out later into the year.
- Key risks to global markets include a deeper-than-expected decline in growth, central bank missteps, persistent inflation and geopolitical tensions.

2 Portfolio Positioning

As of 31 May 2023

- We maintain a cautious stance with an underweight to equities and government bonds in favour of cash. Equities remain vulnerable to a slowing economy and weaker earnings backdrop, while central banks' bias, albeit moderating, towards inflation-fighting remains a potential headwind to bonds. Cash offers liquidity in an uncertain environment and still attractive yields.
- Within equities, we reduced our modest overweight to US value and are now neutral between US growth and value. Despite still favourable relative valuations, cyclical value sectors could face headwinds amid lower growth. However, growth stocks, albeit with extended valuations, could remain supported by declining rates and investors seeking secular growth trends, such as artificial intelligence (AI), amid weakening economic backdrop.
- Within fixed income, we continued to increase the overweight to global high yield bonds to benefit from the attractive yield the asset class offers. We maintain overweights to emerging market dollar sovereigns and local currency because of their yield levels, potentially peaking central bank tightening and expectations of a weaker US dollar.

3 Market Themes

Back in Business

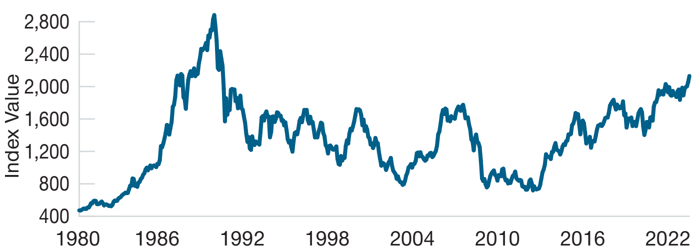
With the Japanese equity market trading near 30-year highs, investors are questioning if it has staying power this time. Japan has been on a long climb back since its 'asset bubble' burst in the early 1990s and was hampered by decades of weak growth and low inflation. However, today does seem different, underpinned by both structural changes and cyclical tailwinds, with inflation finally showing up—a good problem for Japan, unlike others—which can help stimulate consumption through higher wages. Corporate governance reforms, a key part of 'Abenomics,' are also starting to show real progress in improving shareholder value through higher buybacks and dividends. A weaker yen, pent-up demand from reopening, record foreign inflows and still relatively cheap valuations have been strong tailwinds. Despite the optimism surrounding Japan's comeback, the months ahead will be closely watched as the more cyclically oriented economy navigates slower global growth and the Bank of Japan looks to unwind ultra-easy policy. For now, though, Japan looks back in business.

Finding an Uneasy Balance

Mega-cap technology stocks have powered the broader market higher this year, with the top five largest companies accounting for most of the S&P 500's 8%+ return, supported by a decline in rates and expectations that the Fed is nearing the end of its tightening cycle. Better-than-expected earnings, cost-cutting measures as well as the euphoria surrounding AI-related technologies have supercharged the rally, prompting investors to come off the sidelines despite the sky-high valuations. Typically, such narrow market breadth would be a cautionary sign as it masks the broader markets' concerns about weaker growth and earnings ahead. Ironically, those reasons for caution could continue to propel these mega-cap tech stocks higher as they are perceived as more defensive given their secular growth drivers. With the risks of growth stocks' valuations becoming even further extended and challenging economic growth ahead weighing on cyclical sectors, investors are facing a tough balancing act today between value and growth.

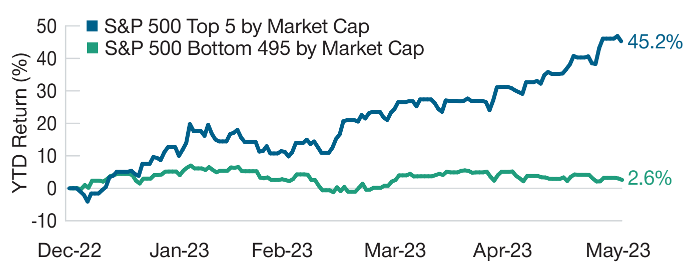
Japanese Equity Market Showing Strength*

As of 31 May 2023



Extremely Narrow Market Year-to-Date†

As of 31 May 2023



Past performance is not a reliable indicator of future performance.

*Japanese equity market is represented by Tokyo Stock Price Index (TOPIX Index). TOPIX–Tokyo Stock Exchange, Inc.

† Returns reference S&P 500 Index. Analysis by T. Rowe Price. Please see Additional Disclosure for more information about this S&P information.

Source: Bloomberg Finance L.P.

REGIONAL BACKDROP

Region	View	Positives	Negatives
Europe	U	▪ Inflation is cooling faster than expected ▪ Oil and gas prices have fallen significantly ▪ Services sector activity has been very resilient	▪ Inflation remains elevated, particularly core inflation ▪ Monetary policy remains restrictive ▪ Quantitative tightening is draining market liquidity
United Kingdom	N	▪ Oil and gas prices have fallen significantly ▪ Headline inflation is falling rapidly ▪ Labour market remains resilient	▪ Inflation remains the highest among major economies ▪ The Bank of England may be forced to hike rates further ▪ Fiscal consolidation may need to be accelerated
United States	U	▪ Consumer spending remains strong ▪ Labour market has been resilient ▪ Manufacturing appears to be stabilising ▪ Artificial intelligence could be a powerful tailwind	▪ Monetary policy remains very tight ▪ Banking sector concerns will impact credit availability ▪ Inflation has proven more persistent than expected
Japan	O	▪ Equity valuations remain very attractive ▪ Uptick in inflation providing increase in wages ▪ Inflows from foreign investors are likely to continue ▪ Corporate governance continues to gradually improve	▪ Monetary policy normalisation may surprise the market ▪ A stronger Japanese yen may weigh on the export sector
Asia Pacific ex-Japan	N	▪ China's recovery, which has been consumer and services driven so far, should continue with a rebound in private investment ▪ Corporate earnings can continue to grow in China as it is still early in its business cycle ▪ In Australia, the consumer is proving resilient despite signs of moderation in retail spending. The government has ample room to provide further support to ease cost-of-living conditions	▪ Mixed signals are raising doubts about the sustainability of China's economic rebound, particularly in relation to exports ▪ Prioritising national security does not help China's fragile business environment ▪ The Reserve Bank of Australia may need to hike more given accelerated wage growth data. The base case remains bearish with an economic slowdown
Emerging Markets	O	▪ China reopening supports an increase in private investment ▪ Further Chinese stimulus is expected ▪ Monetary tightening in most emerging markets (EM) has peaked ▪ Equity valuations are attractive relative to the US	▪ Global trade could suffer with tighter monetary conditions ▪ Geopolitical risks remain elevated ▪ Chinese property deleveraging continues to weigh

U Underweight | N Neutral | O Overweight

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2023

▼ or ▲ Month-Over-Month Change

		Change	Underweight		Neutral	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			■				Outlook remains uncertain due to tight financial conditions, a slowing economy and elevated valuations. However, a resilient labour market, services sector strength and positive sentiment around AI are providing support.
	Fixed Income					■		Rate volatility could remain elevated as central banks continue to balance persistent inflation and growth concerns. Credit sectors continue to offer reasonable valuations with broadly supportive fundamentals.
	Cash					■		Cash currently offers attractive yields and a shorter-duration profile (if rates drift higher) and provides liquidity should market opportunities arise.
	Region							
EQUITIES	US			■				Despite a resilient economy, the outlook remains clouded by Fed uncertainty, manufacturing sector weakness and narrow market breadth. Elevated valuations make US equities less appealing given this backdrop.
	Europe ex-UK			■				Equity valuations are appealing. The EU economy is in a very shallow technical recession. Inflation is cooling faster than expected, easing the pressure on the European Central Bank. However, core inflation (ex food and energy) remains elevated, keeping monetary policy restrictive.
	UK				■			Equity valuations are attractive relative to history and versus major peers. The UK job market remains strong and headline inflation is falling rapidly, but it is still the highest among major economies and may constrain the Bank of England's ability to pause rate hiking.
	Japan					■		Japan's market valuation is attractive relative to global peers, and the reflation/improving governance stories offer unique advantages. Earnings could disappoint if a global recession occurs, and a rising yen, from very cheap levels, would be a headwind for large exporters.
	Developed Asia ex-Japan*				■			China's recovery should continue with a rebound in private investment. Earnings can continue to grow, given China is still early in its business cycle. Some mixed signals are raising doubt about the sustainability of the economic rebound, particularly in relation to Chinese exports.
	Emerging Markets					■		Valuations and currencies are attractive, and central bank tightening may have peaked. Meanwhile, the medium-term outlook in China has improved with reopening and an easing regulatory environment.
	Style and Market Capitalisation							
	Global Growth vs. Value†	▲			■			Relative valuations for value stocks remain attractive; however, a tilt towards higher-quality businesses is important given the weakening macro backdrop. AI could provide a structural tailwind to growth.
	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive upside potential, having already priced in a dire economic scenario with historically attractive relative valuations. Higher-quality bias and selective exposure to regional banks is warranted.

Past performance is not a reliable indicator of future performance.

*Includes Australia.

† 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.

The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2023

▼ 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*		
FIXED INCOME	Euro Government Bonds		■					The ECB should continue rate hiking. Bond supply may increase due to energy compensation. High-quality duration can mitigate some risks given the decreasing likelihood of the global economy dodging a recession.
	Euro Inflation Linked					■		Inflation is expected to ease with healing supply chains, lower energy prices and a committed ECB. The labour market, however, remains tight, and China's reopening may be inflationary.
	Euro Investment-Grade (IG) Corporates			■				Underweight credit risk in expectation of further slowing growth and widening credit spreads, particularly in Europe.
	US IG Aggregate			■				Scope for rates in Europe to rise more than in the US. However, stronger economic growth is expected in the latter.
	Global High Yield	▲					■	Credit fundamentals and higher yields remain supportive. Although default rates are rising from historically low levels, they are not expected to rise significantly above long-term averages.
	EM Dollar Sovereigns					■		Yields are still attractive, while potentially peaking central bank tightening and moderating inflation should also support the sector.
	EM Local Currency					■		Emerging market (EM) currencies and local yields remain at attractive levels but are reflective of cautious sentiment. A weaker US dollar would also be supportive of EM currencies.
	EM Corporates				■			We prefer to overweight sovereigns rather than corporates in emerging markets because credit spreads may widen as the global economy slows. We will be looking for a potential better entry point to consider overweighting EM corporates.
CURRENCIES	EUR vs. USD					■		The US dollar may continue to weaken against narrowing growth and interest rate differentials as the Fed nears its anticipated terminal rate while the ECB keeps hiking.
	EUR vs. JPY			■				The yen remains a safe-haven currency. The valuation of the yen is at an attractive level. Any further changes of policy by the Bank of Japan could support the yen.

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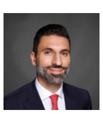
The specific securities identified and described are for informational purposes only and do not represent recommendations.

EUROPEAN INVESTMENT COMMITTEE



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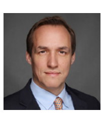

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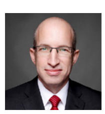

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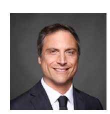

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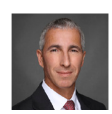

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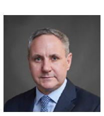

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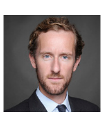

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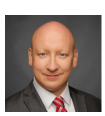

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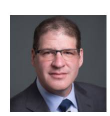

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