T. Rowe Price®
INVEST WITH CONFIDENCE

Global Asset Allocation: The View From the UK

October 2023

1 Market Perspective

- While global growth and inflation are expected to trend lower, much variation exists across regions and countries in terms of the level and pace of deceleration.
- US and Japanese economies are proving more resilient, although the US is seeing some evidence of a cooling consumer. While weakness is seen across Europe as countries work through softer growth and elevated albeit softening inflation, Chinese growth is mixed as recent slowing is being met with a broad range of incremental stimulus measures amid growing concerns surrounding its property sector.
- While global central bank tightening has likely peaked, the US Fed's pledge for "higher for longer" rates has had worldwide impacts on raising yield levels that could create vulnerabilities.
- Key risks to global markets include impacts of the sharp move higher in rates, a deeper-than-expected decline in growth, central bank missteps, reacceleration in inflation, the trajectory of Chinese growth and geopolitical tensions.

2 Portfolio Positioning

As of 30 September 2023

- We maintain a balanced view on risk with a modest underweight to equities. We remain overweight the US, Japan and small caps, where valuations have priced in significant downside. We are underweight Europe, which faces an economic slowdown and still elevated inflation.
- Within fixed income, we remain overweight inflation-linked bonds as a hedge against inflation settling in above central banks' targets. It also reflects the potential for higher commodity prices over the intermediate-term, due to continuing capex decline and moderating productivity trends.
- We remain underweight bonds in favour of cash, as cash offers attractive yields and liquidity should we see opportunities in a period of market dislocation. We have reduced our underweight in gilts and US Treasuries. However, persistent inflation and elevated government bond supply could keep upward pressure on rates.
- Within fixed income higher-yielding sectors, we reduced the overweight in high yield to take some profits. We also remain overweight emerging market bonds on still attractive absolute yield levels and reasonably supportive fundamentals.

3 Market Themes

Costly Capital

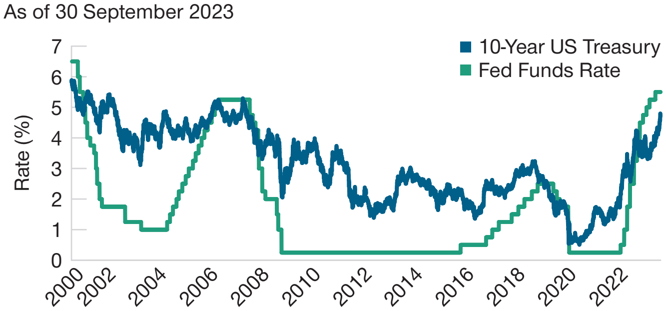
Longer-term global bond yields have gone nearly parabolic over recent weeks, led by US yields, with the 10-year Treasury yield hovering near 4.8%, a 16-year high. The sharp move has been attributed to the Fed's commitment to 'higher for longer,' despite signs of slowing inflation in the pipeline. Further exacerbating the sharp move higher has been the recent rise in energy prices, impending US Treasury supply on rising deficit spending, Fed's quantitative tightening policy reducing its Treasury holdings and concerns over waning foreign demand for US debt. The recent volatility in global yields has unsettled markets fearing the implications of much higher financing costs and what impact the growing losses have on current bondholders. Although higher rates may be warranted to a degree, as markets adjust to a higher inflation regime ahead, as well as the likelihood of higher deficits, it's hard to believe that such an abrupt reset won't end up being too costly for someone.

Tapped Out

Although off recent highs, oil prices are still up more than 20% off their June lows as supply has tightened following the announcement of production cuts by OPEC+,[1] rising demand expectations from China and a depleted US Strategic Petroleum Reserve (SPR). The almost year-long decline in oil prices since June 2022 had played a large role in supporting the decline in inflation in the first half of this year, but the recent sharp rise is disrupting the deflation trend that markets had hoped would move central banks to the sideline. While some of the rise can be explained by near-term supply/demand dynamics, the market has started to recognise that productivity gains over the recent decade contributing to lower energy prices appears to be past peak, leading to higher prices ahead. While a recession could curb demand and lead to lower energy prices over the short term, the new reality that productivity gains may be tapped out is yet another factor that could contribute to higher levels of inflation ahead.

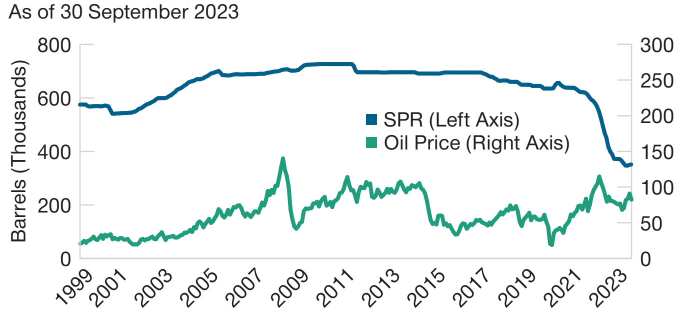
Fed Funds Rate and Treasury Yields Typically Peak Together

As of 30 September 2023



Oil Prices Higher as SPR at Depleted Levels*

As of 30 September 2023



Past performance is not a reliable indicator of future performance.

Source: Bloomberg L.P.

*SPR is the US Strategic Petroleum Reserve.

[1] OPEC+ represents the Organisation of the Petroleum Exporting Countries.

REGIONAL BACKDROP

Region	View	Positives	Negatives
United Kingdom	N	▪ Inflation has begun to moderate ▪ Labour market remains strong ▪ Economy has proven more resilient	▪ The Bank of England (BoE) may be forced to keep rates elevated ▪ Fiscal consolidation may need to be accelerated ▪ Tight labour markets could keep wage inflation elevated
Europe	U	▪ Inflation is cooling faster than expected ▪ European Central Bank (ECB) is close to peak tightening ▪ Labour market has been resilient	▪ Inflation remains elevated, particularly core inflation ▪ Economic growth is slowing ▪ Monetary policy is restrictive
United States	O	▪ Consumer spending remains strong ▪ Labour market has been resilient ▪ Manufacturing appears to be stabilising ▪ Fiscal spending has supported capex	▪ Monetary policy remains very tight ▪ Banking sector concerns will impact credit availability ▪ Interest rates are expected to remain elevated
Japan	O	▪ Uptick in inflation catalyst for increase in wages ▪ Corporate governance continues to gradually improve ▪ Equity valuations remain very attractive	▪ Businesses and consumers are more cautious given return of inflation ▪ Earnings expectations may need to be revised lower
Asia Pacific ex-Japan	N	▪ China economic activity is marginally surprising on the upside as policymakers accelerate stimulative measures ▪ Sentiment is uniformly bearish towards China, such that contrarian investors could look to benefit from cheap valuations ▪ In Australia, positive demographics and a careful central bank may help curb inflation, while resilient house prices and a potential rebound in commodity prices are supportive of markets	▪ In China, property deleveraging remains an overarching goal which dampens domestic activity ▪ Consumer and business confidence in China also remains fragile, and saving is being prioritised over spending ▪ Household disposable income in Australia is falling to levels reminiscent of past recessions. Company earnings are also being revised lower at a fast pace
Emerging Markets	N	▪ Monetary tightening in most emerging markets (EM) has peaked ▪ Equity valuations are attractive relative to the US ▪ Further Chinese stimulus is expected	▪ Global trade could suffer with tighter monetary conditions ▪ Geopolitical risks remain elevated ▪ Chinese consumer and business confidence is fragile

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.

UK INVESTMENT COMMITTEE POSITIONING

As of 30 September 2023

Underweight — *Neutral* — *Overweight*

▼ 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			■				Slowing global growth is balanced with reasonable valuations in many markets, while US valuations are expensive and being challenged by higher rates. However, a resilient labour market, supportive fiscal policies and positive sentiment about artificial intelligence (AI) are supportive.
	Fixed Income					■		Rates continue to move higher and remain volatile as central banks balance lingering inflation and growth concerns. Yields look attractive across fixed income, and credit sectors offer broadly supportive fundamentals.
	Cash					■		Cash currently offers attractive yields and a shorter duration profile as rates reset higher and provides liquidity should market opportunities arise.
	Region							
EQUITIES	US	▲				■		Earnings expectations appear to be improving and economic activity remains resilient, with technology innovation a key differentiator. However, US large-cap equity valuations are expensive, and rising rates are pressuring companies with high interest expense.
	Europe ex-UK			■				European equity valuations remain reasonably appealing, headline inflation has cooled to its lowest level in two years and the economy is showing signs of slowing, easing pressure to hike rates much further. However, with core inflation stubbornly sticky, the ECB policy bias remains restrictive.
	UK				■			Equity valuations are attractive relative to history and major peers. Inflation is tracking lower, and there are signs the economy is slowing. However, domestic factors, such as Brexit adjustments and wage inflation, are inflationary and may keep pressure on the BoE to stay the tightening course.
	Japan					■		Japanese stocks are favoured due to the reflationary story and governance improvements. A weak yen also supports the export sector, even in the face of a global slowdown. However, corporate Japan is highly levered to the global economy, and any Bank of Japan intervention to defend the yen could be a challenge to earnings.
	Developed Asia ex-Japan*				■			China economic activity is marginally surprising on the upside, with policymakers accelerating stimulative efforts, especially in the property sector. However, the overarching goal of deleveraging property dampens domestic activity, while consumer and business confidence are fragile and saving is being prioritised over spending.
	Emerging Markets	▼			■			Valuations and currencies are attractive, and central bank tightening may have peaked. The medium-term outlook in China has improved with economic activity marginally surprising on the upside. However, business and consumer confidence remains fragile, and sentiment is universally bearish.
	Style and Market Capitalisation							
	Global Growth vs. Value†	▲				■		A tilt towards higher-quality businesses is warranted given lingering economic concerns and rising rates. Momentum surrounding AI could provide a structural tailwind to growth.
	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive relative valuations but face margin concerns due to higher exposure to interest rates and higher input costs. Given heightened economic uncertainty, higher-quality bias 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.

UK INVESTMENT COMMITTEE POSITIONING

As of 30 September 2023

Underweight — *Neutral* — *Overweight*

▼ 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	UK Gilts	▲		■				The Bank of England (BoE) may hike rates to address inflation, but by less than expectations to avoid exacerbating an expected recession. This could be interpreted as the BoE being behind the curve, leading to higher gilt yields.
	UK Inflation Linked					■		Inflation may rise as the BoE might hike rates less than market expectations.
	UK Investment-Grade (IG) Corporates				■			Investment grade credit offers good value over the short term.
	US IG Aggregate			■				Elevated inflation and recent economic data could lead the Fed to keep rates higher for longer, weighing on US Treasuries. Investment grade credit spreads may widen if the economy slows down.
	European IG Aggregate			■				Expectation of higher global rates and dynamics of quantitative tightening may weigh on European rates. Credit spreads could widen if the economy enters a recession.
	Global High Yield					■		Credit fundamentals and higher yields remain supportive. Default rates are rising from historically low levels but are not likely to spike as many companies were able to refinance fixed rate debt at lower yields in recent years.
	EM Dollar Sovereigns					■		Yields are still attractive, while peaking central bank tightening cycles and moderating inflation are supportive. China reopening enthusiasm has faded, but modest policy support is expected.
	EM Local Currency					■		EM local valuations are less compelling relative to other sectors. The sector could get a boost from central banks starting to cut rates; however, impact is limited until developed market central banks' hawkish tone shifts.
	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	GBP vs. USD					■		Inflation and a strong labour market may push the BoE to hike rates while the Fed may pause. Even though the UK economy could stagnate or go into recession in the final quarter of the year, the economic momentum in the US is slowing. This could see the US dollar weaken.
	GBP vs. EUR			■				Declining consumer confidence, combined with the largest hit to disposable income since World War II, may cause sterling to weaken against the euro.
	GBP vs. JPY			■				The yen remains a safe-haven currency. The valuation of the yen is at attractive levels. Any hint of change of policy by the BoJ could support the yen.

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

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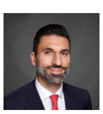

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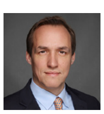

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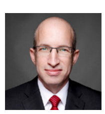

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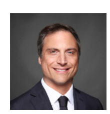

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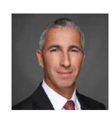

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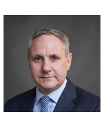

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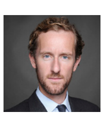

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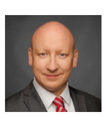

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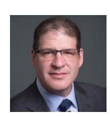

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