T.RowePrice

Global Asset Allocation: The View From the UK

February 2024

1 Market Perspective

- Global growth expectations have stabilised, near the same levels as last year, with disinflation gaining momentum hinting at a global 'soft landing'.
- US growth remains most resilient amongst developed economies, while European growth remains weak. The emerging markets growth outlook is improving, with hopes for stabilisation in China driven by policy support.
- Progress on inflation and stable growth give support for the US Fed and other central banks to pivot towards rate cuts. The Bank of England (BoE) may keep rates high for some more time given the UK economy appeared to be more resilient at the turn of the year. The European Central Bank (ECB) is moving closer to easing as it balances fragile growth and inflation. The Bank of Japan (BoJ) cautiously eyes exiting its negative rate policy in the first half of this year.
- Key risks to global markets include impacts of geopolitical tensions, central banks' policy divergence, a retrenchment in growth, a resurgence in inflation and the trajectory of Chinese growth and policy.

2 Portfolio Positioning

As of 31 January 2023

- We maintain a balanced view on equities supported by positive earnings trends and loosening financial conditions against a backdrop of elevated valuations.
- We trimmed our overweight to Japanese equity, taking profits, and added to US large-cap value as we think a firming cyclical environment, where both growth and inflation stabilise from here, could favour value stocks.
- Within fixed income, we remain underweight government bonds and overweight cash relative to bonds. We believe bond yields are likely to rise because of a resilient economy and central banks not cutting rates as soon as the market expects. Cash continues to provide attractive yields and liquidity to take advantage of potential market dislocations.
- Within fixed income, we remain overweight high yield and emerging market bonds on still-attractive absolute yield levels and reasonably supportive fundamentals.

3 Market Themes

No Quick Fix

Despite a range of stimulus measures rolled out since the second half of 2023, China's economy remains challenged as little so far has led to a meaningful turnaround in activity or its stock market's decline. While Chinese officials pledge more aggressive support, investors are becoming increasingly concerned as there seems to be a disconnect with consumer confidence sliding along with stock prices–slipping to five-year lows. While China's troubled property sector remains at the crux of the country's current issues, record youth unemployment above 20%, a declining population and deflationary pressures caused by weak domestic and export demand have added to the list of headwinds. And while recent data have shown somewhat of a stabilistion in declining home prices in response to stimulus measures, sales remain weak and recent news surrounding the forced liquidation of Evergrande–the country's largest property developer–is yet another challenge to the beleaguered sector. While policymakers look to shore up the foundation of the world's second-largest economy this year, a 'quick fix' is unlikely to be enough, leaving investors hopeful for more substantial policy changes to bring more sustainable growth to China.

Keep On Keeping On

After a strong fourth-quarter rally on rate cut hopes, investors turned a bit skittish at the start of 2024 on better-than-expected economic data pushing out those hopes–but it has since rallied back sending the S&P 500 Index to record highs. It is not surprising to see equity markets cheering the growing prospects of a 'soft landing' with growth intact and inflation easing, giving the Fed the green light to loosen financial conditions in the coming months. Companies too are proving resilient, with earnings expectations improving and easing costs helping to boost margin expansion this year. Big Tech earnings and artificial intelligence euphoria are also lending support. While the momentum may continue, extended valuations and complacency could leave markets ripe for correction. There is a lot riding on the Fed keeping the course on easing that remains vulnerable to incoming data, geopolitical flashpoints are increasing across the globe and the US is nearing another contentious election in the coming months. But for now, it looks like stocks could keep on keeping on, looking through the risks, pointing to the positives on both the economic and earnings front.

Chinese Equities Seeing Weakness Amid Policy Uncertainty[1]

As of 31 January 2024

S&P 500 Index Hits New High in 2024[2]

As of 31 January 2024

Past performance is not a reliable indicator of future performance.

[1] Source: Bloomberg Finance L.P. Data represented by the CSI 300 Index.

[2] Source: Bloomberg Finance L.P. Data represented by the S&P 500 Index. Please see Additional Disclosures.

REGIONAL BACKDROP

Region	Rating	Positives	Negatives
United Kingdom	N	– Inflation has begun to moderate – Bank of England (BoE) may be finished hiking – Labour market has been resilient	– Fiscal consolidation may need to be accelerated – Tight labour markets could keep wage inflation elevated – BoE may be forced to keep rates higher
Europe	U	– Inflation is continuing to cool – ECB is likely finished hiking – Labour market has been resilient	– Inflation remains elevated, particularly core inflation – Monetary policy is restrictive – Economic growth is slowing
United States	O	– Federal Reserve is expected to cut soon – Consumer spending remains strong – Labour market has been very resilient – Earnings expectations are increasing	– Lagged effects of monetary policy remain a risk – Stock valuations have become challenging – Wage growth could pressure corporate margins
Japan	O	– Economy is benefitting from an uptick in inflation – Corporate governance continues to gradually improve – Equity valuations remain attractive	– Monetary policy is becoming incrementally tighter – Yen weakness has weighed on equity market returns – Earnings expectations may need to be revised lower
Asia Pacific ex-Japan	N	– China economic activity is incrementally improving with supportive policies expected to underpin activity moving forward – Sentiment remains bearish towards China, suggesting that contrarian investors could benefit from cheap valuations – In Australia, a resilient housing market is supporting the wealth effect, while elevated wage growth is a fillip for consumer spending	– In China, property deleveraging remains an overarching goal, which dampens domestic activity – China consumer and business confidence are fragile, and saving is being prioritised over spending – Higher interest payments in Australia will negatively impact consumer spending with a lag. Corporate earnings may disappoint due to weak company pricing power
Emerging Markets	N	– Monetary tightening in most emerging markets (EM) has peaked – Equity valuations are attractive relative to the US – Chinese stimulus is expected to continue	– Chinese property deleveraging continues to weigh on activity – Chinese consumer and business confidence are 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 31 January 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 (strong)	Underweight	Neutral	Overweight	Overweight (strong)	
ASSET CLASSES	Equities				■			Sentiment remains positive following Fed pivot. Economic outlook continues to improve, and financial conditions more favourable. Earnings outlook is supportive. Valuations are still challenging but somewhat more reasonable.
	Fixed Income			■				Yields are still attractive, although central banks look towards rate cuts. Volatility could persist amid increased Treasury supply. Credit fundamentals remain supportive; however, spreads are tight.
	Cash					■		Cash continues to offer attractive yields and provide liquidity should market opportunities arise.
EQUITIES	*Region*							
	US					■		Earnings expectations are improving as economic activity remains resilient and Fed policy softens. Technology and pharmaceutical innovation are key differentiators. However, valuations will need to be supported by strong earnings growth.
	Europe ex-UK			■				European equity valuations remain relatively attractive, headline inflation has fallen and the economy has slowed. Even previously sticky core inflation has weakened, easing pressure on the ECB to maintain a restrictive policy bias.
	UK				■			Equity valuations are appealing versus history and major peers. A slowing economy and more reasonable inflation remove any near-term tightening pressure. However, domestic factors, such as Brexit adjustments and average wage growth, are inflationary and may keep rates higher for a while longer.
	Japan					■		Japanese stocks are favoured due to the reflationary story and governance improvements, while broader retail participation in the revamped national savings scheme (NISA) is also supportive. However, a stronger yen could see earnings disappoint, and BoJ policy is set to tighten in the first half of 2024.
	Developed Asia ex-Japan*				■			China economic activity is incrementally improving. Fiscal support and targeted property measures should provide a floor in economic activity. However, leading indicators for export sectors remain weak, while weak domestic activity raises deflationary fears.
	Emerging Markets				■			Valuations and currencies are attractive, and central bank tightening may have peaked. The medium-term outlook in China is improving, with incrementally better economic activity and supportive policy. However, business and consumer confidence remain fragile, and saving is being prioritised over spending.
	Style and Market Capitalisation							
	Global Growth vs. Value†	▼		■				Improving economic outlook and better financial conditions could be supportive for value. Meanwhile, growth faces concentration risk and elevated earnings growth expectations.
	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive relative valuations and stand to benefit more from falling rates. Heightened economic and monetary uncertainty warrants higher-quality bias.

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 31 January 2023

Underweight — *Neutral* — *Overweight* ▼ or ▲ Month-Over-Month Change

		Change	Underweight	Underweight	Neutral	Overweight	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.
FIXED INCOME	UK Gilts			■				A resilient UK economy will allow the Bank of England (BoE) to be more patient with cuts and wait for strong evidence of disinflation. Fiscal issuance and accelerated quantitative tightening (QT) are risks to the long-end of the curve.
	UK Inflation Linked				■			While inflation has been easing, it may accelerate before settling at a lower level.
	UK Investment-Grade (IG) Corporates	▲				■		Investment grade credit offers good value over the short term.
	US IG Aggregate			■				High inflation and economic data could see the Fed keep rates higher for longer, weighing on US Treasuries. Investment grade credit spreads may widen if the economy slows. Strong growth, large fiscal supply and an inverted curve are probably priced in, with yields likely to move lower.
	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					■		Attractive absolute yield levels remain supportive, but tight spreads may be reflecting too optimistic of a backdrop. Default rates are likely to rise to historical long-term averages, although much appears to be priced in.
	EM Dollar Sovereigns					■		Yields still look attractive. With central banks beginning easing cycles and given moderating inflation, EM bonds may benefit from having longer duration.
	EM Local Currency					■		Yields reasonably attractive as expectations for central bank easing, lower inflation and a softer dollar could be supportive of local rates and 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 look for a potentially better entry point to consider overweighting EM corporates.
CURRENCIES	GBP vs. USD					■		The US dollar may soften in a potential benign market environment, in particular as the US economy shows signs of slowing, the US Fed leads on easing rates, and the dollar remains expensive. The cutting cycle in the UK is likely to be less aggressive than priced in.
	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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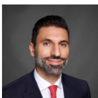
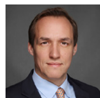
The specific securities identified and described are for informational purposes only and do not represent recommendations.

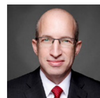
UK INVESTMENT COMMITTEE



Elias Chrysostomou
Associate Portfolio Manager, Equity Division



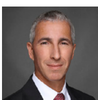
Andrew Keirle
Portfolio Manager, Emerging Markets Local Currency Bonds



Yoram Lustig
Head of Multi-Asset Solutions, EMEA

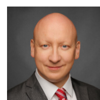
Tobias Mueller
Portfolio Manager, Equity Division

Ken Orchard
Head of International Fixed Income



David Stanley
Portfolio Manager, European Corporate Bonds

Toby Thompson
Portfolio Manager, Multi-Asset Division



Michael Walsh
Portfolio Manager, Multi-Asset Division

Tomasz Wieladek
International Economist

INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so that they can feel more confident.

Additional Disclosures

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