Global Asset Allocation: The View From the UK

January 2024

1 Market Perspective

- Global growth and inflation expectations are broadly lower, with divergence across economies.
- We expect US growth to moderate but remain resilient, while the interconnected economies of Europe and China lag.
- The US Fed has signalled a pivot towards rate cuts in 2024, with the trajectory unclear. The European Central Bank balances fragile growth and inflation. The Bank of Japan cautiously eyes exiting negative rate policy in the first half of this year. Chinese growth remains challenged, with a new year's pledge to offer more stimulus support.
- Key risks to global markets include impacts of geopolitical tensions, central banks divergence, a deeper retrenchment in growth, sticky inflation and trajectory of Chinese growth and policy.

2 Portfolio Positioning

As of 31 December 2023

- We have a balanced view on equities, supported by positive earnings trends and more attractive valuations beyond narrow leadership, against a backdrop of softening growth and still high interest rates. We remain overweight areas of the market with supportive fundamentals, such as small-caps, Japanese equities, global high yield bonds and emerging market debt.
- Within equities, we remain overweight US large-cap growth due to the continued strength of technology and artificial intelligence, US small-caps because of attractive valuations, and Japan because of the reflationary story and governance improvements. Europe ex UK remains an underweight due to slowing economic growth and restrictive monetary policy.
- Within fixed income, we remain modestly overweight cash relative to bonds. 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

Ka-Powell!

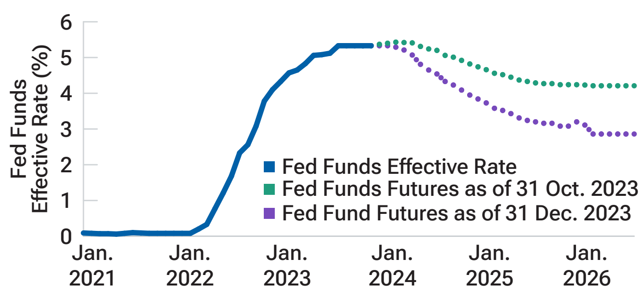
Stock and bond markets soared at the end of 2023 following Chairman Jerome Powell's surprise pivot in policy at the December 13th press conference. Investors were left scrambling to adjust their 2024 rates forecasts as just a month prior, Powell talked down any suggestions that they were close to considering rate cuts. His message at the press conference appeared to be an about-face as he laid out expectations for lower rates next year. While not taking a victory lap, Powell acknowledged that their aggressive policies were indeed having the intended impacts of helping rein in inflation while surprisingly having little impact thus far on employment. With the markets celebrating the 'soft landing', they quickly priced in six rate cuts, double what the Fed has laid out. Given the wide divergence in views, every data point ahead is likely to drive volatility. With US economic growth having proved so resilient and the consumer and unemployment still far from broken, upside surprises to growth or inflation could have markets running back their rate cut views.

Sea-ing Red

Just as inflation is falling closer to central bank targets, investors are seeing red as hopes of impending rate cuts could be delayed as unexpected supply chain disruptions are once again impacting goods and transportation prices. Recent events in the Red Sea have been an unwelcome reminder of the impact that shipping delays related to COVID shutdowns had on supply and goods prices, coupled with the inflationary trends in 2022 as energy prices rose following Russia's invasion of Ukraine. The conflict in Israel and Gaza is having spillover effects across the Middle East, a vulnerable region, where a significant portion of global trade passes through. While the immediate impacts on energy and transportation prices have been mild in comparison to the earlier spike in inflation, it's a reminder that we are on a fragile path back to target level inflation given the heightened geopolitical risk in the world. While goods inflation has come down significantly, post-COVID, and the focus has been on services-related inflation, investors will be keeping an eye on the broadening impacts that geopolitical risks could have on global trade and inflation.

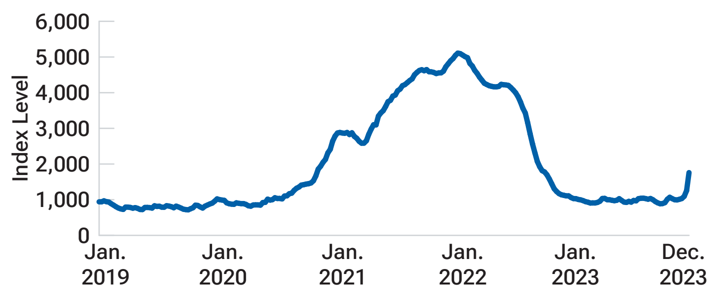
Market Pricing in More Aggressive Cuts[1]

As of 31 December 2023



Shipping Costs Have Risen but Remain Below COVID Levels[2]

As of 31 December 2023



Past performance is not a reliable indicator of future performance.

[1] Source: Bloomberg L.P.

[2] Sources: Bloomberg L.P. and Shanghai Containerized Freight Index (SCFI). The SCFI reflects the spot rates of the Shanghai export container transport market. It includes both freight rates (indices) of 15 individual shipping routes and a composite index.

REGIONAL BACKDROP

		Positives	Negatives
United Kingdom	N	– Inflation has begun to moderate – Bank of England (BoE) may be finished hiking – Labour market continues to show resilience	– 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 cooling faster than expected – European Central Bank (ECB) may be finished hiking – Labour market has been resilient	– Inflation remains elevated, particularly core inflation – Economic growth is slowing – Monetary policy is restrictive
United States	O	– Federal Reserve has pivoted – Consumer spending remains strong – Labour market has been resilient – Earnings expectations are increasing	– Lagged effects of monetary policy remain a risk – Banking sector concerns will impact credit availability – Economic data have been surprising to the downside recently
Japan	O	– Economy is benefitting from an uptick in inflation – Corporate governance continues to gradually improve – Equity valuations remain very 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 continue – 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 encouraging 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	– Global trade remains relatively weak – 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 December 2023

▼ or ▲ Month-Over-Month 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.
	Change						
ASSET CLASSES	Equities			■			Sentiment shifted dramatically positive on Fed pivot. Although economic outlook remains uncertain, financial conditions have improved. Earnings outlook is supportive, but valuations are becoming challenged again.
ASSET CLASSES	Fixed Income		■				Yields attractive as central banks look towards rate cuts. Volatility could persist amid increased Treasury supply. Credit fundamentals remain supportive, although spreads are tight after a recent risk-on rally.
ASSET CLASSES	Cash				■		Cash continues to offer attractive yields and provides liquidity should market opportunities arise.
	Region						
EQUITIES	US				■		Earnings expectations are improving as economic activity remains resilient and rates come off peak. Technology and pharmaceutical innovation is a key differentiator. However, valuations will need to be supported by strong earnings growth.
EQUITIES	Europe ex-UK		■				European equity valuations remain reasonably attractive, headline inflation has fallen noticeably and the economy is showing signs of slowing, easing pressure to hike rates further. However, with core inflation proving stubbornly elevated, the ECB policy bias remains restrictive.
EQUITIES	UK			■			Equity valuations are appealing relative to history and major peers. Core inflation has fallen, while signs of economic slowdown potentially ease inflationary pressure. However, domestic factors, such as Brexit adjustments and growth in average wages, are inflationary and may keep rates at higher levels for a while longer.
EQUITIES	Japan				■		Japanese stocks are favoured due to the reflationary story and governance improvements. There is also upside potential from broader retail participation in the revamped national savings scheme. However, any appreciation in the yen could see earnings disappoint, while BoJ policy will start to tighten in the first half of 2024.
EQUITIES	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 continue to be weak, while the overarching goal of deleveraging property is dampening domestic activity.
EQUITIES	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						
EQUITIES	Global Growth vs. Value†				■		Improving economic outlook and better financial conditions could be supportive for value. Meanwhile, momentum surrounding artificial intelligence and weight loss drugs could provide a structural tailwind to growth.
EQUITIES	Global Small-Cap vs. Large-Cap†				■		Small-caps offer attractive relative valuations and stand to benefit more from falling rates. Given heightened economic uncertainty, higher-quality bias is warranted.

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*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 December 2023

Underweight — *Neutral* — *Overweight*   ▼ or ▲ Month-Over-Month 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.**
	Change						
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				■		Despite a recent rally, yields still look attractive, with peaking central bank tightening cycles and moderating inflation supportive.
	EM Local Currency				■		Expectations for central bank easing, lower inflation and a softer dollar could be supportive of local rates and currencies. However, yields are less attractive after a recent rally.
	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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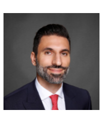
The specific securities identified and described are for informational purposes only and do not represent recommendations.

UK INVESTMENT COMMITTEE



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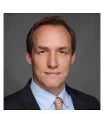

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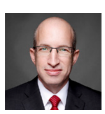

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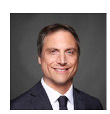

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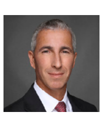

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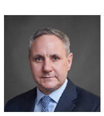

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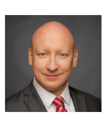

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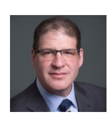

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INVEST WITH CONFIDENCE™

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.

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