T. Rowe Price

Global Asset Allocation: The View From Europe

March 2024

1 Market Perspective

- There is firming in global growth expectations, with recent data tilted more positively, while inflation continues to decelerate across most regions.
- US growth remains most resilient amongst developed economies, while weak European growth is potentially bottoming. The emerging markets growth outlook is improving, with hopes for stabilisation in China driven by policy support.
- While progress on inflation gives support for the US Fed to pivot towards cuts, resiliency in the economy could delay the start. The European Central Bank is moving closer to easing amid fragile growth and as inflation has moved past its peak. The Bank of Japan 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 29 February 2024

- We shifted to a modest overweight position in equities, which was funded from cash and supported by a firming growth and disinflation backdrop, positive earnings trends and reasonable valuations outside of large-cap growth.
- We continued to add 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 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.

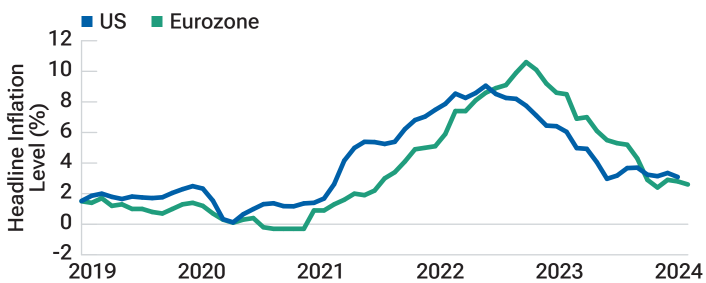
3 Market Themes

Getting Back Together

Heading into 2024, the consensus view was that the US Fed was going to be the leader in cutting interest rates among developed market central banks, given its progress on inflation and higher current rates, while the European Central Bank (ECB) was seen as a laggard given stickier inflation and despite weaker growth. Fast-forward to today, US growth has surprised to the upside and the pace of disinflation has slowed, and the labour market has remained resilient, pushing out rate cut expectations. Conversely, a quickening in disinflation, now below the US, and fragile growth in the eurozone, have pulled forward expectations of an ECB rate cut. However, the ECB appears to also be taking a patient approach, cautiously monitoring wage growth and upcoming labour negotiations to assure that inflation pressures are abating. Ironically, the diverging dynamics between the two appear to be bringing the Fed and ECB back together again, at least from a timing standpoint, with markets now pricing in rate cuts to start in June for both. And while more synchronised moves by the central banks could help mitigate volatility, there remains a lot of uncertainty between now and June that could push them back apart.

Inflation: Eurozone Catching Down With US[1]

As of 29 February 2024



No Bull!

Within fixed income markets, the bull steepening of the yield curve has been a consensus trade among bond managers that has proven elusive thus far this year, with everyone betting that the Fed would soon be embarking on cutting rates, sending short-term yields falling faster than longer-term yields—a positive for short-term bond prices—as the curve re-steepened. The yield curve has now been inverted for a record number of months, typically a harbinger of an impending recession. The resilience of the US economy and its still gradual progress with disinflation are increasing the odds that the economy skirts a recession this time around. While welcomed news on the economic front, it has given the Fed breathing room to stick with the 'higher for longer' plan to ensure inflation is indeed under control, and it is an unwelcome development for those betting short rates were coming down soon. Those hopes also extended to equity investors, bullishly expecting falling short-term yields would entice the over USD 6 trillion pile of cash parked in money market funds back into risk assets. While the bet on the bull steepening has proven elusive thus far, we do expect it—albeit later and more gradually playing out.

Yield Curve: Short Yields Remain Anchored

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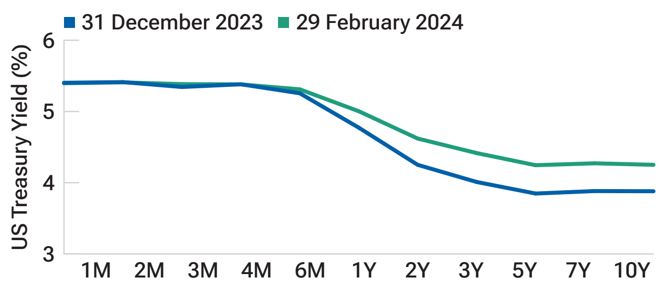

Past performance is not a reliable indicator of future performance.

Source: Bloomberg L.P.

[1] US inflation is represented by the US Consumer Price Index Headline (year over year). Eurozone inflation is represented by the Eurozone Harmonised Index of Consumer Prices (year over year).

REGIONAL BACKDROP

		Positives	Negatives
Europe	U	– Inflation has been steadily declining – ECB is expected to cut soon – Labour market has been resilient	– Monetary policy is restrictive – Economic growth remains weak – Geopolitical uncertainty is heightened
United Kingdom	N	– Inflation has been steadily declining – Bank of England (BoE) is likely to cut this year – 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
United States	O	– Federal Reserve is expected to cut this year – 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 welcomes inflation after decades fighting deflation – Corporate governance continues to gradually improve – Weak yen has made export prices more competitive	– Economic data have been mixed, challenging the reflation theme – Political turmoil could derail the economic policy agenda – Expectations are high, raising the bar for upside surprises
Asia Pacific ex-Japan	N	– China central government fiscal support can boost domestic confidence – China fundamentals are broadly supportive – In Australia, labour market tightness may have peaked, while fiscal stimulus is expected to alleviate loss of real income	– Prolonged China deflation is a concern, and domestic consumption remains weak – Sentiment in China remains universally bearish – Reserve Bank of Australia is more hawkish than other central banks, suggesting a delayed easing cycle. Consumer confidence remains challenged
Emerging Markets	N	– Monetary tightening in most emerging markets (EM) has peaked – Equity valuations are attractive relative to the US – Chinese economy incrementally improving	– 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.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 29 February 2024

▼ 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.
ASSET CLASSES	Equities	▲				■		Sentiment remains positive as the firming economic and inflation outlook should continue to drive earnings higher. Valuations are challenging, but reasonable, notably outside of large-cap growth.
ASSET CLASSES	Fixed Income			■				Yields remain attractive, although volatility could persist as markets price in central bank expectations, as well as growth and inflation outlooks. Credit fundamentals remain supportive; however, spreads remain tight.
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 financial conditions are improving. Technology and pharmaceutical innovation are key differentiators. However, valuations will need to be supported by strong earnings growth.
EQUITIES	Europe ex-UK			■				European equity valuations remain relatively attractive, and headline inflation has fallen. However, the economy has stalled, and fears are that Europe is on the verge of recession.
EQUITIES	UK				■			Equity valuations are appealing versus history and against major peers. However, domestic factors, such as Brexit adjustments and average wage growth, are inflationary and may keep rates higher for a while longer.
EQUITIES	Japan					■		Japanese stocks are favoured due to the reflationary story and governance improvements, while ongoing currency weakness is a boon for exporters. However, short-term economic data are mixed and political turmoil could derail the economic policy agenda.
EQUITIES	Developed Asia ex-Japan*	▼		■				In Australia, economic data are bottoming, but fears are that the country could slip into recession.
EQUITIES	Emerging Markets				■			Valuations and currencies are attractive, and central bank tightening may have peaked. China government policy support and broadly supportive market fundamentals are positives. However, geopolitical tensions with the US could rise in advance of the US presidential election.
	Style and Market Capitalisation							
EQUITIES	Global Growth vs. Value†			■				Improving economic outlook and better financial conditions could be supportive for value. A steepening yield curve and improving prospects for energy demand should be positive for value-oriented sectors.
EQUITIES	Global Small-Cap vs. Large-Cap†					■		Small-caps offer attractive relative valuations and stand to benefit more if rates fall from here. Heightened economic and monetary uncertainty warrants higher-quality bias.

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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.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 29 February 2024

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.

	Asset	Change	Underweight (strong)	Underweight	Neutral	Overweight	Overweight (strong)	Commentary
FIXED INCOME	Euro Government Bonds			■				Euro government bonds remain under pressure as monetary policy expectations are repriced. Because the macroeconomic environment is different from past cutting cycles, the ECB could adopt a gradual cutting path.
FIXED INCOME	Euro Inflation Linked				■			Inflation is expected to ease further as the economy slows down. The European labour market, however, remains tight, keeping a degree of upward pressure.
FIXED INCOME	Euro Investment-Grade (IG) Corporates					■		Euro investment-grade credit offers good value over the short term although spreads remain tight.
FIXED INCOME	US IG Aggregate			■				Stubborn inflation and a resilient economy could see the US Federal Reserve keep rate higher for longer than the market currently expects. Meanwhile, investment-grade spreads remain tight.
FIXED INCOME	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.
FIXED INCOME	EM Dollar Sovereigns					■		Yields still look modestly attractive. With central banks embarking on easing cycles and inflation continuing to moderate, EM bonds may benefit from longer-duration profile.
FIXED INCOME	EM Local Currency					■		Yields are close to historical averages as expectations for central bank easing, lower inflation and a softer dollar could be supportive of local rates and currencies.
FIXED INCOME	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	EUR vs. USD					■		In a benign market environment, the US dollar may soften, particularly from current expensive levels. Signs of a slowing US economy could see the Fed lead on easing rates.
CURRENCIES	EUR vs. JPY	▲			■			The yen remains a safe-haven currency, and current valuation levels are attractive. Any hint of policy change by the Bank of Japan could support a stronger yen.

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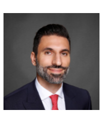
EUROPEAN INVESTMENT COMMITTEE



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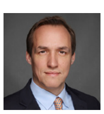

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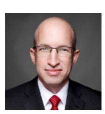

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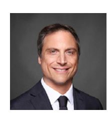

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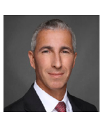

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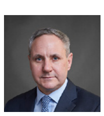

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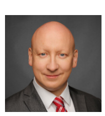

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INVEST WITH CONFIDENCE™

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 Disclosure

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