



Global Asset Allocation Viewpoints and Investment Environment

NOVEMBER 2018

1 MARKET THEMES As of October 31, 2018

U.S. FALL FROM GRACE OR PAUSE THAT REFRESHES?

U.S. equities have swung from near-peak levels toward correction territory in little more than a month, with secular growth stocks that had led the advance over the last few years among the largest decliners. A confluence of factors weighed, including rising U.S.-China trade tensions, signs the U.S. Fed was undeterred on their mission to raise rates, and concerns that earnings growth was peaking. The “buy the dip” mentality that we experienced earlier in the year was notably absent this time around, bringing valuations to their lowest levels in more than two years. Are equities more attractive now that valuations reflect some of the risks? Markets will be attuned to earnings guidance for clues on how risks may be weighing on expectations and sentiment.

U.S.-CHINA COLD (TRADE) WAR?

Earlier this year, many investors thought the Trump administration’s trade escalation with China was a short-term negotiating tactic intended to secure trade concessions. But given the U.S. administration’s recent rhetoric and China’s focus on “Made in China 2025,” investors are beginning to factor in that existing tariffs may stay in place for an extended period of time as both sides dig in. Furthermore, the probability of another round of tariffs is increasing as the existing U.S. tariffs on Chinese goods are scheduled to automatically increase at the beginning of next year. And while the G20 meeting later this month may provide an opportunity to make progress on the trade front, both sides remain far apart on strategic issues, and relations may remain tense over the coming years.

RISING RATES – WHERE TO HIDE?

Could this be a year of negative returns for both stocks and bonds? Bonds have traditionally provided ballast to help offset periods of equity drawdowns. But given where we are in the interest rate cycle, rising rates seem to have spooked both bond and stock investors. October’s global equity sell-off brought many equity market returns into negative territory for the year at a time when U.S. Treasury returns have been pressured by higher rates. It’s been nearly 50 years since we’ve experienced a year where both the S&P 500 and 10-Year Treasuries posted negative returns in the same calendar year. Assuming the Fed stays the course into 2019, stocks and bonds could face similar headwinds from rising rates.

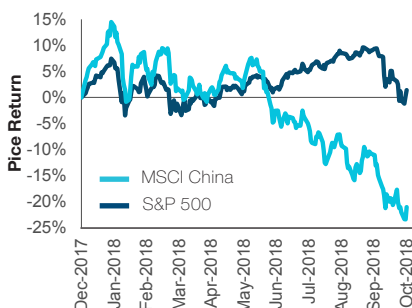
S&P 500 FORWARD P/E RATIO

December 31, 2015 – October 31, 2018



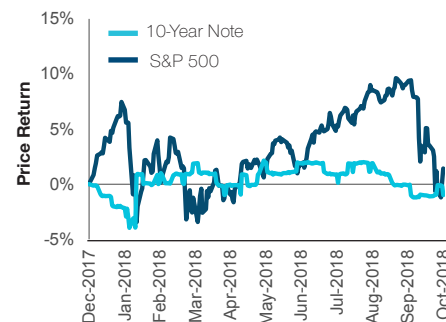
S&P 500 VS. MSCI CHINA

December 31, 2017 – October 31, 2018



S&P 500 VS. U.S. 10-YEAR TREASURY NOTE

December 31, 2017 – October 31, 2018



Past performance is not a reliable indicator of future performance.

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2 PORTFOLIO POSITIONING

EQUITY

- We moderated our underweight position to equities from sidelined cash following October’s market sell-off. Valuations have retreated to more attractive levels, helping compensate for downside risks, including higher rates and trade tensions.
- We increased our overweight position in equities outside the U.S., where we see greater upside potential due to more attractive valuations, cyclical upside, and room for margin expansion.
- We added to our emerging markets (EM) equities overweight where we see attractive valuations opportunities, supported by cheaper currencies.

FIXED INCOME

- We modestly reduced our overweight position to floating rate loans. While default expectations remain low, loan terms have weakened and liquidity for this asset class can be challenging in a risk-off environment.
- We maintained our overweight position in EM debt. Valuations in this area remain attractive, particularly when compared with high yield and investment-grade credit. While EM debt faces headwinds from a stronger U.S. dollar, trade tensions, and rising rates, we do not see risks to this area as systemic.

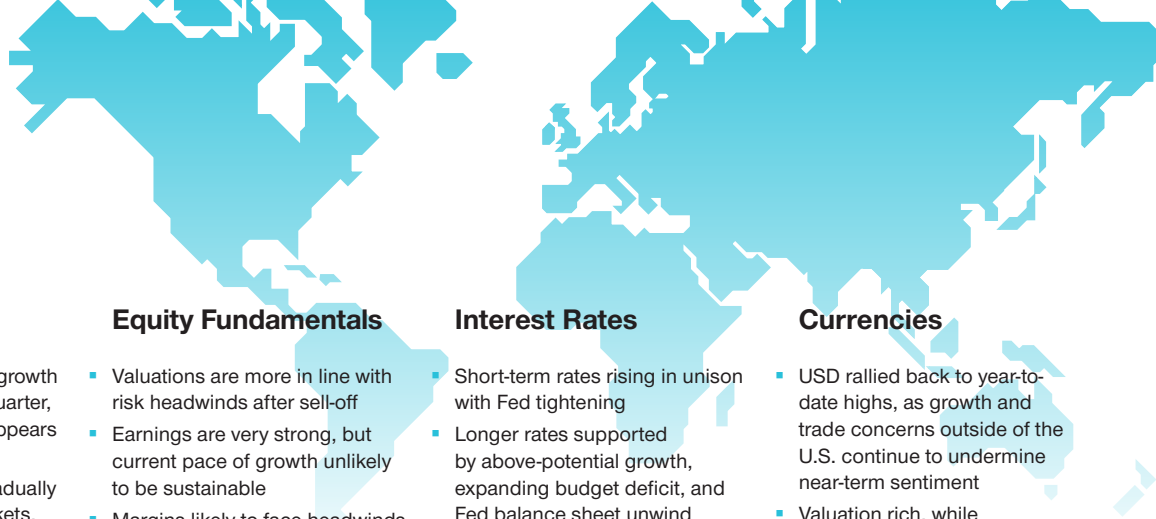
REAL ASSETS

- We remain underweight real assets equities as we are cautious on the long-term prospects for energy and commodity prices given continued advances in productivity and moderating growth in China.
- Real estate investment trusts (REITs) proved to be a defensive asset during the recent sell-off, but valuations have become somewhat less attractive on a relative basis. Fundamentals remain broadly positive with muted supply growth and healthy occupancy rates, but rising rates remain a headwind.

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3 Regional Backdrop

As of October 31, 2018



Macroeconomic

- Gross domestic product (GDP) growth remained strong into the third quarter, supported by consumers, but appears likely to have peaked
- Inflation and labor costs are gradually rising despite tighter labor markets, keeping recession risks relatively low despite the advanced age of the cycle
- The potential for a sharp acceleration in capex spending is deteriorating as business owners remain cautious amid trade policy uncertainty

Equity Fundamentals

- Valuations are more in line with risk headwinds after sell-off
- Earnings are very strong, but current pace of growth unlikely to be sustainable
- Margins likely to face headwinds from higher rates, wages, and input costs

Interest Rates

- Short-term rates rising in unison with Fed tightening
- Longer rates supported by above-potential growth, expanding budget deficit, and Fed balance sheet unwind

Currencies

- USD rallied back to year-to-date highs, as growth and trade concerns outside of the U.S. continue to undermine near-term sentiment
- Valuation rich, while increasing internal and external deficits weigh long term

UNITED STATES

DEVELOPED EUROPE

- Eurozone GDP growth has slowed to its lowest level in four years, as growth in Germany moderated and Italy stalled
- The standoff between the EU and the Italian government over the proposed Italian budget deficit continues, with no end in sight

- Valuations are modestly attractive relative to the U.S.
- Earnings results have been somewhat disappointing, but growth remains in positive territory

- Fading economic growth and geopolitical fears have kept German 10-year rates in a low and narrow range all year
- The standoff between the EU and the Italian government has led to a substantial widening of the spread between Italian and German yields

- Near-term political risks have continued to dominate the euro backdrop, with evidence of negative sentiment weighing on risk assets
- However, QE unwind and relatively attractive valuations should support the euro over the medium term

UNITED KINGDOM

- The economy continues to improve, with risks (outside of Brexit) now skewing toward the upside
- Both the UK and the EU have stepped up planning for a "no deal" situation, a risk that has significantly increased over the last few months

- Valuations continue to trade at a discount to global equity markets
- Allocations to UK equities by global investors are at extremely low levels

- The Bank of England kept rates on hold at 0.75% but indicated that it would need to step up the pace of rate hikes if Brexit advances more positively
- While near-term rates continue to be heavily dependent on Brexit negotiations, economic data suggest the economy is no longer depressed

- Valuations remain attractive versus history; however, the outcome of Brexit negotiations remains highly uncertain and will ultimately decide the near-term fate of GBP

DEVELOPED ASIA & PACIFIC

- Trade tensions remain a key issue within the region, but growth remains healthy
- The Japanese economic slowdown is expected to continue in 2019, although further fiscal stimulus measures are planned
- Despite very low levels of unemployment, Australian economic activity continues to soften, with the housing market an area of concern

- Valuations within the region remain attractive relative to other developed markets, but earnings remain vulnerable to a slowdown in global trade
- Japanese equities remain supported by better relative valuations, strong earnings growth, and gradually improving corporate governance, but earnings remain vulnerable to yen volatility
- Australian margins are being squeezed by cost pressures, causing earnings revisions to trend lower

- A continued gradual rise in global yields could impact long rates in the region
- The BoJ continues to hold its accommodative policy, but concerns on the long-term impacts of such policies remain a source of debate
- RBA becoming more dovish, as wage growth remains subdued and housing concerns are heightened

- Unaltered monetary policy with weak economic indicators has put pressure on the yen, but valuations should be supportive over the medium term
- Trade wars will remain an important driver for the Australian dollar, which has retested its recent low levels

EMERGING MARKETS

- Amid lingering U.S.-China tensions, EM economies face a potential slowdown in export demand
- Policymakers continue to provide accommodative measures, but sentiment remains negative
- Political risks remain elevated but have faded in several key countries

- Valuations are attractive, as stocks have sold off broadly on trade concerns, U.S. dollar strength, and currency weakness
- Earnings growth remains relatively strong, but expectations are fading

- Interest rates trending higher as financial conditions tighten in response to rising inflation and higher U.S. rates
- Many central banks have shifted toward a tightening bias, but this is partially offset by a PBOC easing

- EM currencies continue to be volatile, even if bellwethers of risk sentiment, Turkey, Argentina, and Brazil, have stabilized
- Valuations remain broadly attractive relative to history but are unlikely to rebound in the near term without external catalyst

4 Asset Allocation Committee Positioning

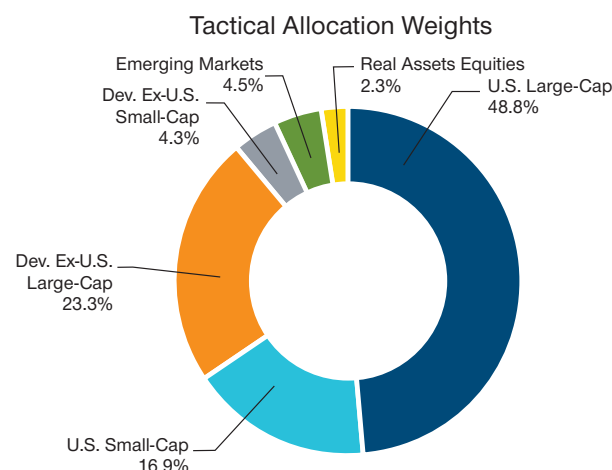
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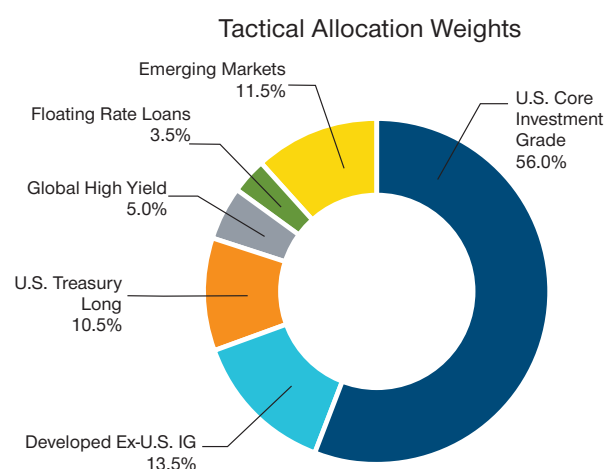
5 Portfolio Implementation

As of October 31, 2018

Equity	Neutral Weight	Tactical Weight	Relative Weight
■ U.S. Large-Cap	51.0%	48.8%	-2.2%
■ U.S. Small-Cap ¹	15.0%	16.9%	+1.9%
■ Dev. Ex-U.S. Large-Cap	21.0%	23.3%	+2.3%
■ Dev. Ex-U.S. Small-Cap	4.0%	4.3%	+0.3%
■ Emerging Markets	4.0%	4.5%	+0.5%
■ Real Assets Equities	5.0%	2.3%	-2.8%
Total Equity:	100.0%	100.0%	



Fixed Income	Neutral Weight	Tactical Weight	Relative Weight
■ U.S. Core Investment Grade	55.0%	56.0%	+1.0%
■ Developed Ex-U.S. IG (Hedged)	15.0%	13.5%	-1.5%
■ U.S. Treasury Long	10.0%	10.5%	+0.5%
■ Global High Yield	8.0%	5.0%	-3.0%
■ Floating Rate Loans	2.0%	3.5%	+1.5%
■ Emerging Markets - (Local/Hard Currency)	10.0%	11.5%	+1.5%
Total Fixed Income:	100.0%	100.0%	



¹U.S. Small-Cap includes both small- and mid-cap allocations.

Source: T. Rowe Price. Unless otherwise stated, all market data are sourced from Factset. Copyright 2018 FactSet. All Rights Reserved.

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Neutral equity portfolio weights representative of a U.S.-biased portfolio with a 70% U.S. and 30% International allocation; includes allocation to real assets equities. Core fixed income allocation representative of U.S.-biased portfolio with 55% allocation to U.S. Investment Grade.

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