Global Asset Allocation Viewpoints and Investment Environment

JUNE 2019

1 Portfolio Positioning

As of 31 May 2019

Risks Rising—Favoring Income over Capital Appreciation

- We further **reduced exposure to equities in favor of cash and bonds** as valuations are extended against a backdrop of rising risks, including slowing growth and escalating trade tensions.
- We moved to an **overweight high yield bonds** as yield levels remain attractive and fundamentals healthy. Relative to equities, high yield bonds currently offer similar return expectations with a lower volatility profile.
- We **pared back developed equities outside the U.S.** given their exposure to slowing global manufacturing and rising risks from trade tensions.

2 Market Themes

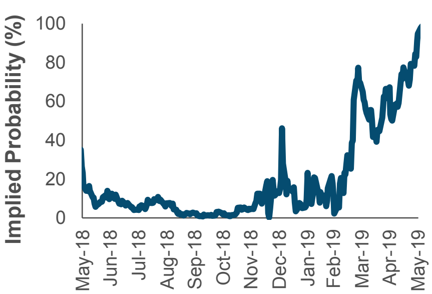
As of 31 May 2019

Fed Put Affirmed, For Now

Equity markets experienced one of the largest U.S. Federal Reserve relief rallies in history as global central banks policies have pivoted to a more dovish stance in the face of low inflation and moderating growth. However, equity markets reversed course in May as it became evident that a trade deal was not imminent and quickly priced in nearly three rate cuts by the Fed by end of 2020. While the Fed has historically cut rates after a sustained pause, such an aggressive retrenchment in policy seems unlikely outside of an outright recession. Recent reassuring comments by Chairman Powell reinforced the markets' expectation that the Fed put is alive and well. While tough to handicap the outcome of trade, for now markets think the Fed will provide a backstop if things worsen from here.

Futures Market Expectations for Fed to Cut in 2019

31 May 2018 to 31 May 2019

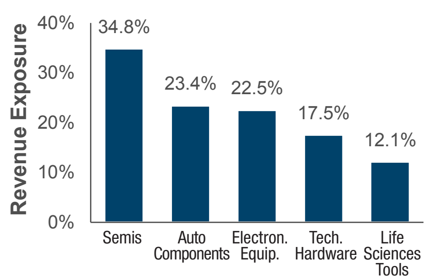


Technology in the Crosshairs

Technology companies have found themselves in the crosshairs of the U.S.-China trade dispute. Not only are provisions on intellectual property, forced technology transfer, and critical technologies at the center of the dispute, the escalation in tensions has had an immediate impact on business sentiment and technology supply chains. With a shaky global growth outlook and waning business confidence, actual capital expenditures could disappoint particularly in cloud computing, which had been a bright spot in 2018. Additionally, non-tariff barriers, such as blacklisting Huawei and questions surrounding the supply of rare earth metals, represent yet another risk to investors in the technology space. The question remains, is this simply a temporary setback for business models fueled by secular change or are the long-term industry dynamics truly in question?

S&P 500 Industries With Highest Revenue Exposure to Mainland China

As of 31 May 2019

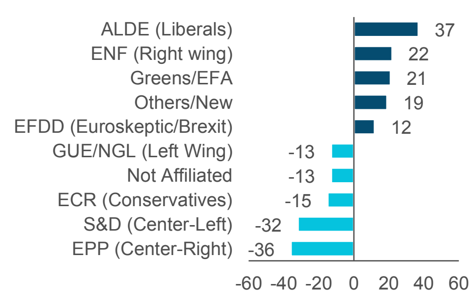


EU Rebuke of the Establishment

The European parliamentary elections confirmed that the populist surge continues with established parties suffering substantial losses, often at the hands of eurosceptics. The backlash has been increasing as social policies have failed to keep up with the inequalities caused by the liberalization of trade and outsourced manufacturing. Election results in Italy will likely strengthen the ruling anti-EU Lega party's push for fiscal loosening whereas results in France show lack of popular support for Macron's reformist economic agenda. Results in the UK were particularly concerning, as the newly formed Brexit party won the most votes with the governing Conservative party coming in a distant fourth. Unfortunately, investors seeking a safe haven from the political uncertainty prevalent in the U.S. and China are unlikely to find it in Europe.

European Parliament Change in Seats

As of 31 May 2019



Past performance is not a reliable indicator of future performance.

Sources: The European Union (https://election-results.eu/tools/comparative-tool/), Bloomberg Finance L.P., and Financial data and analytics provider FactSet.

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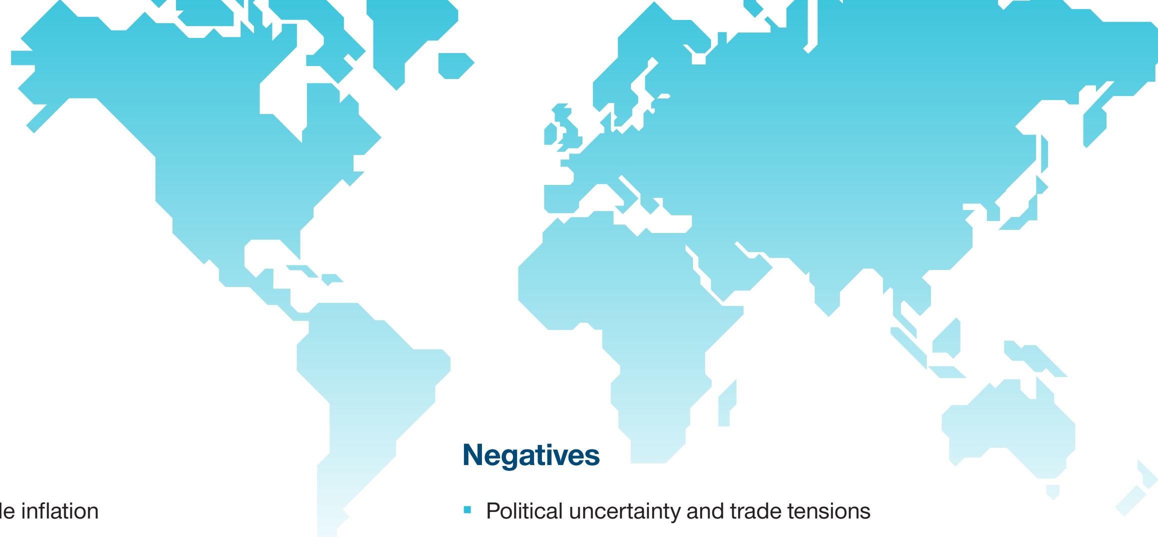


3 Regional Backdrop

As of 31 May 2019

United States

Positives

- Dovish Fed, stable inflation
- Healthy consumer spending, strong employment, and improving wages
- Lower rates driving a rebound in housing
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of world

Negatives

- Political uncertainty and trade tensions
- Moderating economic growth with fading fiscal stimulus
- Faltering capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and elevated margins
- Muted near-term earnings expectations
- Elevated corporate and government debt levels

Europe

Positives

- Monetary policy remains very accommodative
- Indirect beneficiary of China stimulus
- Economic growth showing signs of stabilization

Negatives

- Eurozone economic growth is muted, with limited scope for ECB to respond
- Export weakness, vulnerable to trade and China growth
- Banking sector remains challenged
- The composition of the new EU Parliament could lead to difficulties

Developed Asia/Pacific

Positives

- Dovish stance from both the BOJ and RBA
- China stimulus could support regional trade
- Japanese fiscal stimulus implemented in April
- Broadly attractive valuations, particularly in Japan
- Improving corporate governance trends in Japan

Negatives

- Highly exposed to slowing global economic growth and trade tensions
- Japanese economic and earnings growth continue to be much weaker than hoped
- Australia facing slowing economy with weakness in housing
- Australian earnings facing increased margin pressure

Emerging Markets

Positives

- Muted (but rising) inflation, more dovish Fed gives central banks flexibility to ease
- Beneficiary of Chinese stimulus
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle

Negatives

- Export-driven economies are highly vulnerable to rising trade tensions
- Instability in several key markets (Turkey, Argentina, and Brazil) could persist
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused
- Currencies facing renewed pressure

4 Asset Allocation Committee Positioning

As of 31 May 2019

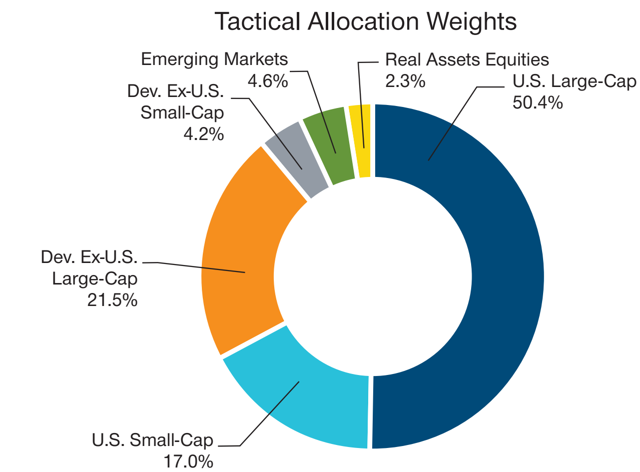
▼ or ▲ Month-Over-Month Change

		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 CLASS	Equities	▼		■				Above-average valuations with risks rising. Equities vulnerable to further political uncertainty and economic weakness
	Bonds	▲				■		Yields lower amid slowing global growth, credit fundamentals still supportive, provides buffer to equity volatility
	Cash	▲				■		U.S. yields most attractive among developed markets but may have peaked with Fed on hold
EQUITIES	*Regions*							
	U.S.	▲		■				Earnings growth weakening with valuations elevated. U.S. market less vulnerable to slowing global growth
	Global Ex-U.S.	▼				■		Valuations attractive relative to history amid concerns over slowing global growth and trade
	Europe				■			Growth outlook pressured amid concerns over exports, banking system, and elevated political risks
	Japan				■			Trends in corporate governance and monetary policy supportive. Export dependency and stronger yen potential headwinds
	Emerging Markets					■		Valuations attractive amid growing trade concerns and earnings weakness. China stimulus measures and more dovish Fed should be supportive
	Style							
	U.S. Growth					■		Secular growth companies could offer more durable growth in lower-growth environment, but tech supply chains are at risk and regulatory concerns are
	U.S. Value			■				Valuations fair but lack catalyst with moderating economic growth and flat yield curve
	Global Ex-U.S. Growth					■		Quality growth bias, less exposed to global growth slowdown but valuations extended versus history
	Global Ex-U.S. Value			■				Cyclical orientation and financials exposure challenged by persistently low rate environment and fading growth outlook
	Capitalization							
	U.S. Large-Cap			■				Softening earnings environment and global trade linkage are risks with valuations trending above historical averages
	U.S. Small-Cap					■		Valuations modestly attractive, but cyclical headwinds, high leverage, and wage pressure are risks
	Global Ex-U.S. Large-Cap				■			Exposed to strength of global trade. Upside dependent on impact of China stimulus
	Global Ex-U.S. Small-Cap				■			Valuations reasonable. Weak domestic growth trends and political uncertainty weighing on confidence in key markets
	Inflation-Sensitive							
	Real Assets Equities		■					Declining global growth outlook could weigh on commodities. U.S. REITs supported by healthy fundamentals and low rates
BONDS	U.S. Investment Grade	▼		■				Yields low on concerns from growth but limited inflation upside. IG corporate spreads still tight relative to history
	Developed Ex-U.S. IG (Hedged)				■			Large short-rate differential between U.S. and other developed markets has made hedged USD yields more attractive, but durations remain extended
	Inflation-Linked				■			Inflation expectations low but could drift higher with support from more dovish Fed
	Global High Yield	▲				■		Yield carry attractive with near-term default expectations low but late stage of credit cycle a risk
	Floating Rate Loans				■			Yield level remain attractive but step ups less likely with Fed pivot
	EM Dollar Sovereigns					■		Yields are attractive but heightened political uncertainty in several key markets remains a significant headwind
	EM Local Currency					■		EM currency valuation remains attractive, but volatility likely to be elevated over the near term

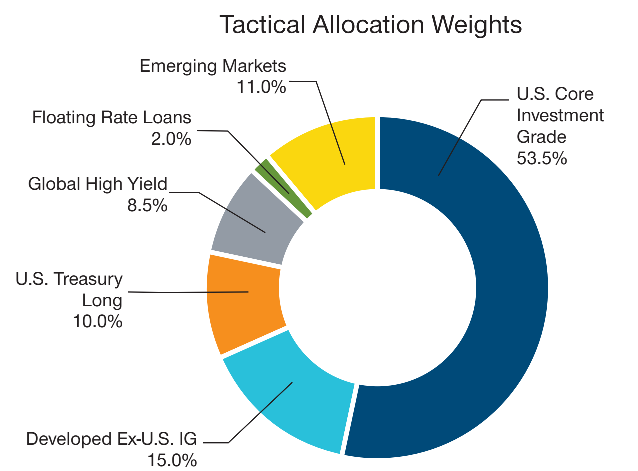
5 Portfolio Implementation

As of 31 May 2019

Equity	Neutral Weight	Tactical Weight	Relative Weight
U.S. Large-Cap	51.0%	50.4%	-0.6%
U.S. Small-Cap[1]	15.0%	17.0%	+2.0%
Dev. Ex-U.S. Large-Cap	21.0%	21.5%	+0.5%
Dev. Ex-U.S. Small-Cap	4.0%	4.2%	+0.2%
Emerging Markets	4.0%	4.6%	+0.6%
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%	53.5%	-1.5%
Developed Ex-U.S. IG (Hedged)	15.0%	15.0%	0.0%
U.S. Treasury Long	10.0%	10.0%	0.0%
Global High Yield	8.0%	8.5%	+0.5%
Floating Rate Loans	2.0%	2.0%	0.0%
Emerging Markets - (Local/Hard Currency)	10.0%	11.0%	+1.0%
Total Fixed Income:	**100.0%**	**100.0%**	



[1] U.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 2019 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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