Global Asset Allocation Viewpoints and Investment Environment

APRIL 2019

1 Portfolio Positioning

As of 31 March 2019

Exuberance May be Overdone

- We **moderated our position in small-cap stocks in the U.S.** given recent strength and favorable liquidity in the face of moderating domestic growth.
- We continued to **reduce our exposure to developed market value stocks outside the U.S. in favor of growth** as value-oriented sectors within those regions, such as financials, may be challenged by moderating economic growth.
- We **added to hedged international bonds** as they offer an attractive hedged yield for U.S. dollar investors.

2 Market Themes

As of 31 March 2019

Risk On!

On the back of the Fed's dovish pivot, risk assets are off to a banner start with the MSCI AC World (on a local currency basis) and the S&P 500 indexes returning 12.4% and 13.6%, respectively over the first three months of the year. This is their strongest quarterly return since September 2009 and the best first quarter since 1998. Commodities were also up strongly as oil had its best quarter in almost a decade. Does this foreshadow significant upside for the remainder of the year, or will markets trade sideways from here? Unusually strong starts have historically led to further strength, but with the bond market signaling that the end of the cycle may be near, markets may need another catalyst to carry the torch from here.

Return to New Normal

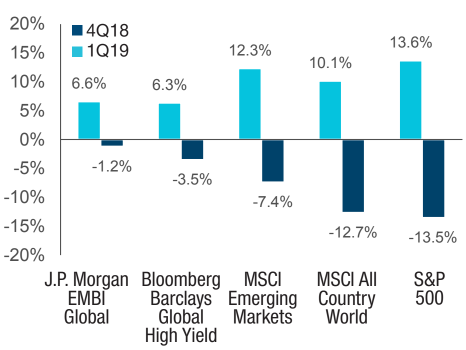
Government bond yields around the world continued to slide as dovish signals for both the Fed and the ECB sent the yield on the 10-year U.S. Treasury note to its lowest level since December 2017. While the U.S. Fed sees solid underlying economic fundamentals, they have indicated their willingness to be patient in the face of low inflation and slowing growth, and the bond market is pricing in an outright cut in 2019. At the same time, the ECB has further delayed its timeline for policy normalization and announced additional stimulus, highlighting concerns about slowing global growth. Is the recent rally in rates simply an extension of the cycle or a harbinger of recession?

Coming in for a (Soft) Landing

China's recent economic slump appears to be stabilizing as the effects of stimulus measures begin to filter through the economy. Chinese fixed-asset investment and manufacturing purchasing managers' index (PMI) beat expectations last month thanks to infrastructure spending, with the PMI posting the biggest increase in seven years and the first significant monthly improvement since mid-2018. Additionally, despite ongoing posturing from negotiators from the U.S. and China, both sides seem keen to broker a deal to head off an escalation of a trade war that has been weighing on global sentiment. While clearly positive, will these green shoots be enough to stabilize global growth?

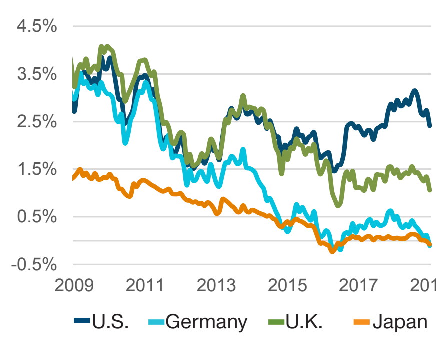
Asset Class Performance

Price Return in USD as of 31 March 2019



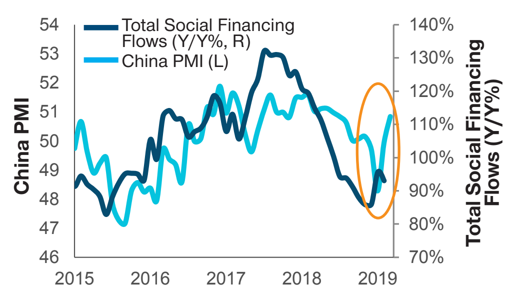
10-Year Government Bond Yields

31 March 2009 to 31 March 2019



China Credit Growth vs. China PMI

1 January 2015 to 1 March 2019



Past performance is not a reliable indicator of future performance.

Sources: J.P. Morgan Chase & Co., Standard & Poor's, Haver Analytics / People's Bank of China, Caixin / IHS. Financial data and analytics provider FactSet.

3 Regional Backdrop

As of 31 March 2019

United States

Positives

- More dovish Fed, stable inflation
- Healthy consumer spending, improving wages
- Trade deal with China appears likely
- Greater share of secularly advantaged companies than rest of world

Negatives

- Moderating economic growth with fading fiscal stimulus
- Late-cycle concerns: tight labor market, rising wages, and elevated margins
- Political uncertainty and trade tensions
- Deteriorating near-term earnings expectations

Europe

Positives

- Highly accommodative monetary policy
- Indirect beneficiary of China stimulus
- Political headwinds in Italy and France have eased

Negatives

- Eurozone economy struggling, with limited scope for ECB to respond
- Export weakness, vulnerable to trade and China growth
- Political unity remains a concern with Brexit looming
- Banking sector remains challenged

Developed Asia/Pacific

Positives

- BOJ committed to aggressive policy, RBA on hold in face of rising inflation
- China stimulus could support regional trade
- Japanese fiscal stimulus to be 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
- Stronger yen on risk aversion could weigh on exports
- Australia facing slowing economy with weakness in housing
- Australian earnings down sharply

Emerging Markets

Positives

- Muted inflation, more dovish Fed give central banks flexibility to ease
- Chinese stimulus appears to be taking hold
- U.S.-China trade deal appears likely
- Global trade indicators appear to be stabilizing
- With growth in tech sector, less tied to commodity cycle

Negatives

- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused
- Highly linked to global trade
- Currencies face renewed pressure
- Near-term earnings expectations deteriorating
- Instability in Turkey could persist

4 Asset Allocation Committee Positioning

As of 31 March 2019

▼ or ▲ Month-Over-Month Change

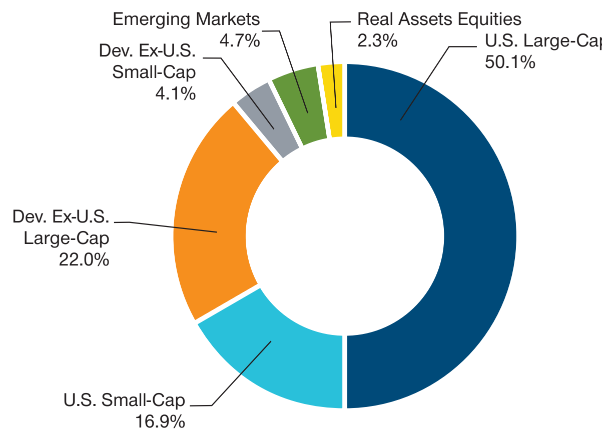
		Change	Underweight		Neutral	Overweight		These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
ASSET CLASS	Equities			■				Fundamentals and valuations are reasonable, but cycle is aging, earnings expectations are falling, and trade remains a risk
	Bonds					■		Yields range-bound with modest inflation and Fed on hold. Credit fundamentals broadly supportive amid elevated leverage and moderating earnings
	Cash				■			U.S. yields most attractive among developed markets but may have peaked with Fed on hold
EQUITIES	*Regions*							
	U.S.			■				Earnings growth moderating with valuations fair. 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 weakening 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					■		Supported by more dovish Fed, softer U.S. dollar expectations, China stimulus measures, and easing trade tensions
	Style							
	U.S. Growth					■		Secular growth companies offer more durable growth in lower-growth environment, but valuations remain above historical averages
	U.S. Value			■				Cheap valuations 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. Valuations have moderated and are in line with 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, less exposed to trade and global growth concerns. High leverage and wage pressure are risks
	Global Ex-U.S. Large-Cap					■		Reliant on strength of global trade. Upside dependent on impact of China stimulus
	Global Ex-U.S. Small-Cap			■				Susceptible to domestic growth trends. Political uncertainty weighing on corporate and consumer 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 stable rates outlook
BONDS	U.S. Investment Grade	▼		■				Yields remain low with limited concerns from growth and inflation upside. IG corporate 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 remain low on slower growth and lower energy prices, making valuation more compelling but lacking catalysts
	Global High Yield			■				Yield carry attractive with near-term default expectations low but late stage of credit cycle a risk
	Floating Rate Loans				■			Rate reset feature less attractive with Fed on hold. Loan terms have weakened and liquidity a risk
	EM Dollar Sovereigns					■		Yields are attractive relative to fundamentals supported by slower Fed path and fading country-specific risks
	EM Local Currency					■		Despite healthy rebound, EM currencies valuation remains attractive in select areas

5 Portfolio Implementation

As of 31 March 2019

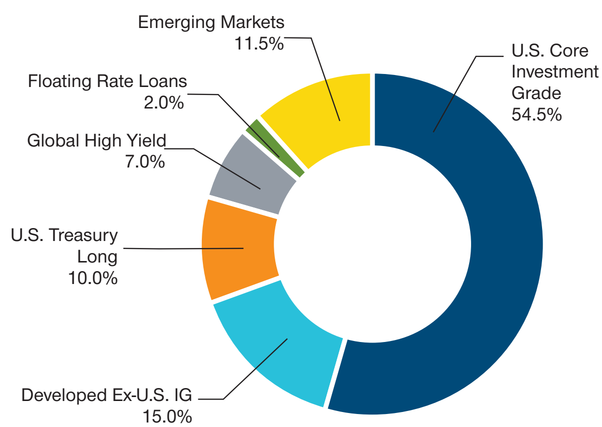
Equity	Neutral Weight	Tactical Weight	Relative Weight
U.S. Large-Cap	51.0%	50.1%	-0.9%
U.S. Small-Cap[1]	15.0	16.9	+1.9
Dev. Ex-U.S. Large-Cap	21.0	22.0	+1.0
Dev. Ex-U.S. Small-Cap	4.0	4.1	+0.1
Emerging Markets	4.0	4.7	+0.7
Real Assets Equities	5.0	2.3	-2.8
Total Equity:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Fixed Income	Neutral Weight	Tactical Weight	Relative Weight
U.S. Core Investment Grade	55.0%	54.5%	-0.5%
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	7.0	-1.0
Floating Rate Loans	2.0	2.0	0.0
Emerging Markets - (Local/Hard Currency)	10.0	11.5	+1.5
Total Fixed Income:	**100.0%**	**100.0%**	

Tactical Allocation Weights



[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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