Global Asset Allocation Viewpoints and Investment Environment

JULY 2019

1 Portfolio Positioning

As of 30 June 2019

Uncertainty warrants caution

- We remain **modestly underweight equities in favor of cash and bonds** as valuations are extended against a backdrop of rising risks.
- We **favor 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 are **overweight emerging market equities** as they should benefit from the trade truce, dovish central banks, and a weaker U.S. dollar.

2 Market Themes

As of 30 June 2019

Don't fight the Fed?

Global manufacturing data continued to sow doubts on the outlook for economic growth as the impact of lingering trade uncertainty on corporate sentiment has become more pronounced. Data has continued to weaken over the first half of the year with the global manufacturing PMI falling below the expansion threshold in June, marking the lowest level since February 2016. Weakness was broad-based with the headline number and new orders falling in all regions. Despite these persistent signs of a weakening global environment, markets seem confident that central banks will provide a backstop. So far, central bank rhetoric has supported markets but, if needed, will the response be sufficient to reverse the economic trend?

Synchronized pivot

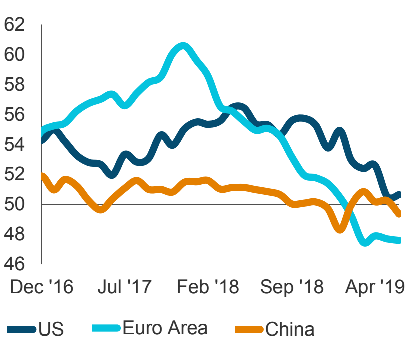
Macro risks remain to the downside as business sentiment and global capex have been adversely impacted by trade uncertainty leading expectations for central bank easing to become increasingly synchronized. Following the pivot by the U.S. Federal Reserve, recent comments from ECB President Draghi increased expectations that monetary easing would be forthcoming in the eurozone, and Australia has moved to an easing stance. This could be good news for emerging markets as dovishness in developed markets and signs that the U.S. dollar strengthening trend may have peaked would provide cover to cut rates amid still low inflation.

Truce but not real progress

While expectations for the Trump and Xi meeting at the G-20 Summit were low, the resulting truce is a positive development following months of escalating tensions. But will it be enough to support markets from here? Risk assets had already rallied strongly year-to-date on the back of dovish comments from the Fed and the ECB, with U.S. equities posting the best start to the year since 1997. However, recent strength of safe-haven assets, such as gold and sovereign bonds raises some concerns. While the truce avoided further escalation, the core issues (e.g., intellectual property) remain unresolved. While markets rejoiced in the detente, there are no clear signs that the trade war is over.

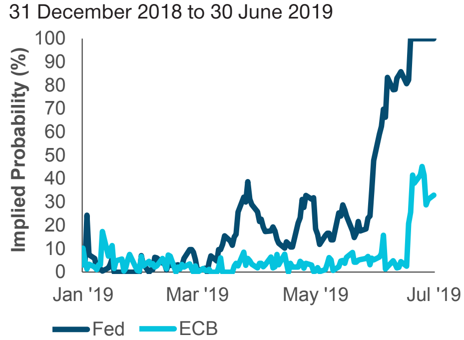
Manufacturing PMI

31 December 2016 to 30 June 2019



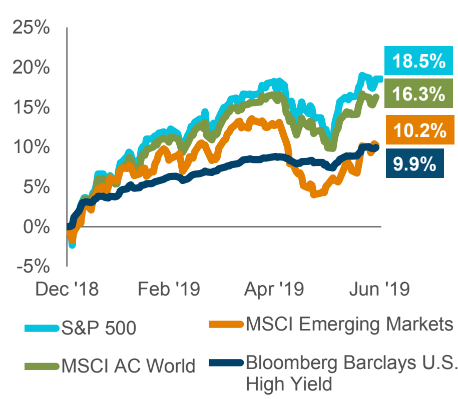
Futures Market Expectations for Rate Cut in July

31 December 2018 to 30 June 2019



Year-to-Date Total Return

Figures are in USD As of 30 June 2019



Past performance is not a reliable indicator of future performance.

Sources: The European Union, MSCI, Standard & Poor's, and Financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved. Please see additional disclosures on the final page.

3 Regional Backdrop

As of 30 June 2019

	Positives	Negatives
United States	▪ Dovish Fed, stable inflation ▪ Healthy consumer spending, strong employment, and improving wages ▪ Lower rates driving a rebound in housing ▪ Pause in trade war escalation ▪ Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of world	▪ Election in 2020 ▪ Slowing economic growth with fading fiscal stimulus ▪ Muted near-term earnings expectations ▪ Faltering capex spending and corporate confidence ▪ Late-cycle concerns: tight labor market, rising wages, and elevated margins ▪ Elevated corporate and government debt levels
Europe	▪ Monetary policy remains very accommodative ▪ Indirect beneficiary of China stimulus ▪ Economic growth showing signs of improvement ▪ Dividend yields remain strong	▪ Economic growth is muted ▪ Limited scope for ECB to stimulate further ▪ 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	▪ 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	▪ Highly exposed to slowing global economic growth and trade tensions ▪ Japanese economic and earnings growth continue to be weak, VAT increase looms ▪ Australia facing slowing economy with weakness in housing ▪ Australian earnings facing increased margin pressure
Emerging Markets	▪ Muted inflation, more dovish Fed give 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	▪ 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

4 Asset Allocation Committee Positioning

As of 30 June 2019

▼ or ▲ Month-Over-Month Change

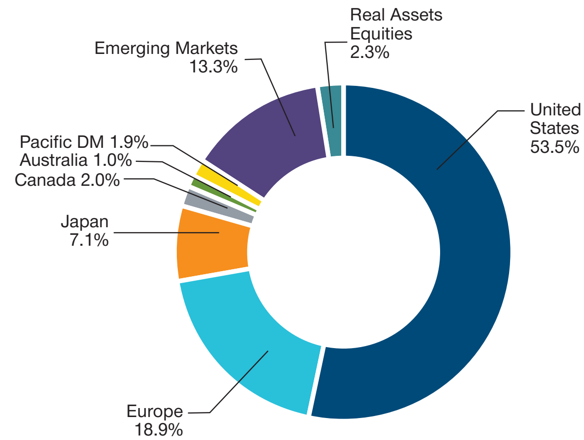
		Change	Underweight		Neutral	Overweight		These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.
ASSET CLASS	Equities			■				Above-average valuations with risks rising. Equities vulnerable to further political uncertainty 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 expected Fed cut
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 under pressure 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 likely to offer more durable growth in lower-growth environment, but tech supply chains are at risk and regulatory concerns are growing
	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 drivers include 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 remains 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 30 June 2019

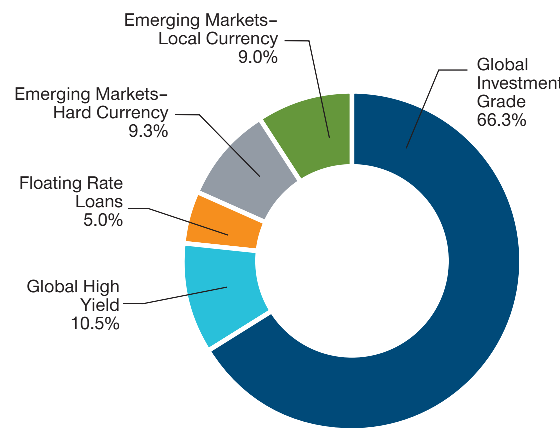
Equity	Neutral Weight	Tactical Weight	Relative Weight
United States	52.0%	53.5%	+1.6%
Europe	18.2%	18.9%	+0.7%
Japan	6.8%	7.1%	+0.3%
Canada	2.9%	2.0%	-1.0%
Australia	2.1%	1.0%	-1.0%
Pacific – Developed Markets	1.6%	1.9%	+0.3%
Emerging Markets	11.4%	13.3%	+1.9%
Real Assets Equities	5.0%	2.3%	-2.8%
Total Equity:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Fixed Income	Neutral Weight	Tactical Weight	Relative Weight
Global Investment Grade (Hedged)	70.0%	66.3%	-3.8%
Global High Yield	10.0%	10.5%	+0.5%
Floating Rate Loans	5.0%	5.0%	+0.0%
Emerging Markets – Hard Currency	9.0%	9.3%	+0.3%
Emerging Markets – Local Currency	6.0%	9.0%	+3.0%
Total Fixed Income:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Source: T. Rowe Price.

Neutral equity portfolio weights broadly representative of MSCI All Country World Index regional weights; includes allocation to real assets equities. Core global fixed Income allocation broadly representative of Bloomberg Barclays Global Aggregate Index regional weights.

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Even if the asset allocation is exposed to different asset classes in order to diversify the risks, a part of these assets is exposed to specific key risks.
Equity risk – in general, equities involve higher risks than bonds or money market instruments.
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Currency risk – changes in currency exchange rates could reduce investment gains or increase investment losses.
Default risk – the issuers of certain bonds could become unable to make payments on their bonds.
Emerging markets risk – emerging markets are less established than developed markets and therefore involve higher risks.
Foreign investing risk – Investing in foreign countries other than the country of domicile can be riskier due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments.
Interest rate risk – when interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
Real estate investments risk – real estate and related investments can be hurt by any factor that makes an area or individual property less valuable.
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