Global Asset Allocation Viewpoints and Investment Environment

SEPTEMBER 2019

1 Portfolio Positioning

As of 31 August 2019

Watching and Waiting

- We **remain underweight equities in favor of cash and bonds** as downside risks remain from trade tensions and moderating global growth.
- We are **modestly overweight high yield bonds** as they offer attractive income and the consistent coupon helps to buffer downside relative to equities.
- We are **overweight emerging market equities** as valuations remain attractive and could find support from more dovish central banks, low inflation, and a moderation in U.S. dollar strength.

2 Market Themes

As of 31 August 2019

Brexit: Mess gets messier

With only weeks left until the 31 October deadline, UK Prime Minister Boris Johnson moved to suspend Parliament to thwart opposition lawmakers' chances of blocking a no-deal Brexit, causing both consumer and business confidence to tumble. Johnson's gamble was designed to put pressure on the EU but instead pitted himself against Parliament, which moved swiftly to block his proposed exit at any cost. While the probability of a near-term disorderly exit has significantly decreased, neither side seems to have a plan to resolve the key sticking points with Brussels. In the meantime, the move promises further economic uncertainty with another delay and likely an election this year.

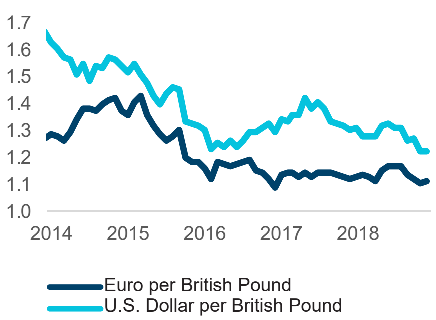
Mind the (trade) gap

Risk assets had a turbulent August amid renewed anxieties surrounding trade, with the U.S. announcing new tariffs and Chinese authorities allowing the yuan to weaken against the dollar while halting U.S. agricultural purchases. However, markets rallied into month-end as trade rhetoric abated on both sides despite additional tariffs on key consumer goods, such as electronics and footwear, which are due to go into effect on 1 September. While a resumption of dialogue provides hope, the gap that has formed between the two sides from retaliatory tariffs has made the possibility of a near-term substantive deal even more remote. Meanwhile, trade is already weighing on growth and capital decisions and may spill over to the consumer.

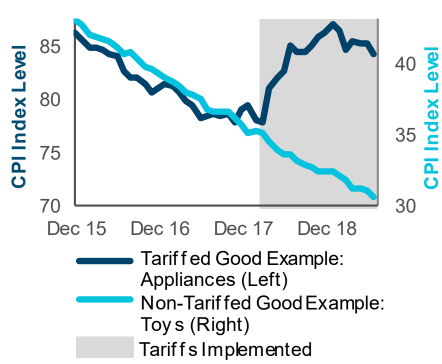
Shop till the economy drops

Amid continued manufacturing weakness and a slowing economy, the U.S. consumer appears unfazed as spending (which accounts for more than two-thirds of U.S. economic activity) grew at its fastest rate since 2014. The consumer has benefited from solid wages, a tight labor market, low interest rates, and low inflation as existing tariffs have been largely absorbed by companies to date. However, with the most recently announced tariffs that are expected to take effect in September and December being largely consumer goods focused, the consumer may no longer be immune to the trade war. If companies pass the tariff impacts on to the consumer and demand suffers, recession odds could sharply tick upward.

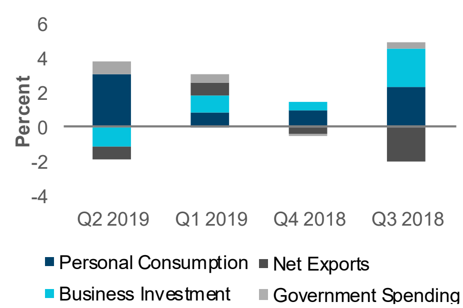
British Pound Cross Rates
Five Years Ending 31 August 2019



Inflation: Tariffed vs. Non-Tariffed Goods
31 December 2015 through 31 July 2019



U.S. GDP Breakdown



Sources: Bloomberg Finance L.P., Financial data and analytics provider FactSet.
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3 Regional Backdrop

As of 31 August 2019

United States

Positives

- Fed easing, low inflation
- Healthy consumer spending, strong employment, and improving wages
- Lower rates supportive of housing
- Greater share of secularly advantaged and innovative companies (e.g., cloud computing, internet retail) than rest of world

Negatives

- Trade negotiations remain adversarial
- 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

Positives

- Monetary policy increasingly accommodative
- Indirect beneficiary of China stimulus
- Dividend yields remain strong
- Talk of fiscal stimulus

Negatives

- Economic growth remains under pressure
- Geopolitical risks remain elevated (e.g., Brexit)
- Export weakness, vulnerable to trade and China growth
- Limited scope for ECB to stimulate further
- Banking sector remains challenged

Developed Asia/Pacific

Positives

- Dovish stance from both the BOJ and RBA
- China stimulus could support regional trade
- Japanese fiscal stimulus
- 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 weak, VAT increase looms in October
- Australia facing slowing economy with weakness in housing
- Australian earnings facing increased margin pressure

Emerging Markets

Positives

- Muted 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
- GDP forecasts for EM economies continue to decline
- Instability in several key markets (Turkey, Argentina) could persist
- Slowing long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused

4 Asset Allocation Committee Positioning

As of 31 August 2019

▼ or ▲ Month-Over-Month Change

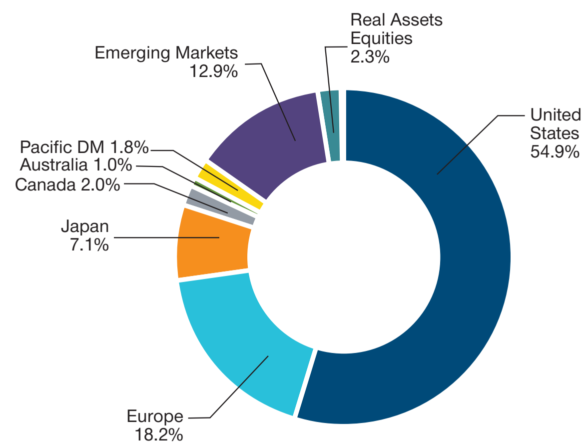
		Change	Underweight		Neutral	Overweight		**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**
ASSET CLASS	Equities			■				Above-average valuations with risks elevated; equities vulnerable to further political uncertainty and slowing global growth.
	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 past peak with Fed easing.
EQUITIES	*Regions*							
	U.S.			■				Earnings growth weak with valuations above average; 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					■		More dovish Fed, China stimulus measures, and cheap currencies supportive but susceptible to growing trade concerns and earnings weakness.
	Style							
	U.S. Growth					■		Secular growth companies offer more durable growth in a 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 sensitive 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			■				Weak earnings environment, global trade linkage, and strong USD are risks with valuations trending above historical averages.
	U.S. Small-Cap					■		Valuations attractive but cyclical headwinds, high leverage, and wage pressure are risks.
	Global Ex-U.S. Large-Cap				■			Susceptible to global trade weakness but could benefit from 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 lower rates.
BONDS	U.S. Investment Grade			■				Yields lower on growth concerns with limited inflation; IG corporate spreads still tight relative to history.
	Developed Ex-U.S. IG (Hedged)				■			ECB's renewed bond-buying program supportive, hedged USD yields more attractive, but durations remain extended.
	Inflation-Linked				■			Inflation expectations low with decelerating growth and Fed possibly behind the curve.
	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 easing and liquidity remains a concern.
	EM Dollar Sovereigns					■		Yields are attractive and central banks supportive but heightened political uncertainty in several key markets remains a 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 August 2019

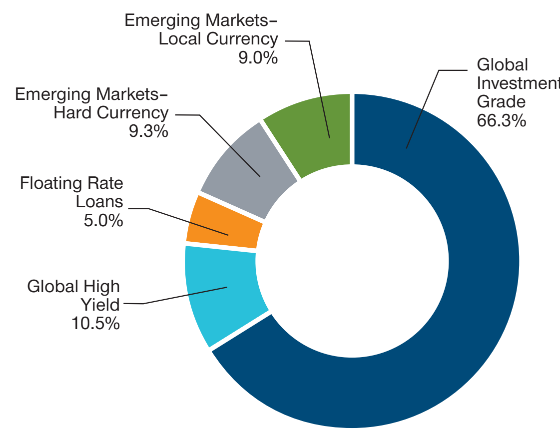
Equity	Neutral Weight	Tactical Weight	Relative Weight
United States	53.3%	54.9%	+1.6%
Europe	17.6%	18.2%	+0.6%
Japan	6.8%	7.1%	+0.3%
Canada	2.9%	2.0%	-1.0%
Australia	2.0%	1.0%	-1.0%
Pacific – Developed Markets	1.5%	1.8%	+0.3%
Emerging Markets	11.0%	12.9%	+1.9%
Real Assets Equities	5.0%	2.3%	-2.8%
Total 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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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.
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