# Global Asset Allocation Viewpoints

**January 2020**

## 1 Portfolio Positioning

As of 31 December 2019

### Stepping Into Cyclical Exposure

- Modestly added to equities from bonds as sentiment has continued to improve for risk assets due to supportive monetary policy and further stabilization in global growth.
- Within equities, we added to markets outside the U.S., including emerging markets and global ex-U.S. value, based on attractive relative valuations, improving global growth, and potential upside in currencies, notably within emerging markets.
- Within fixed income, we further trimmed duration exposure by rotating from long-term U.S. Treasuries into less duration-sensitive floating rate loans that should be supported with the Fed on hold.

## 2 Market Themes

As of 31 December 2019

### Making "Global ex-U.S." Great Again?

In 2019, the U.S. stock market continued its streak of outperforming, rising by more than 31% versus 21% for the rest of the world, as measured by the S&P 500 Index and the MSCI All Country World ex-U.S. Index (in USD). More amazing is that U.S. markets have outpaced the rest of the world by nearly 200% over the past decade. Markets outside the U.S. were plagued by a decade that saw the European debt crisis, two recessions in Europe, bouts of political uncertainty across the globe, including Brexit, and more recently, the impacts of the trade war. Entering 2020, markets outside the U.S. are benefiting from easing trade tensions and stabilizing global growth, which could be a tailwind due to their more cyclically oriented economies. Given these improvements, still attractive relative valuations, and cheap currencies—notably within emerging markets—could this be the beginning of the end of U.S. (markets) exceptionalism or just a temporary reprieve?

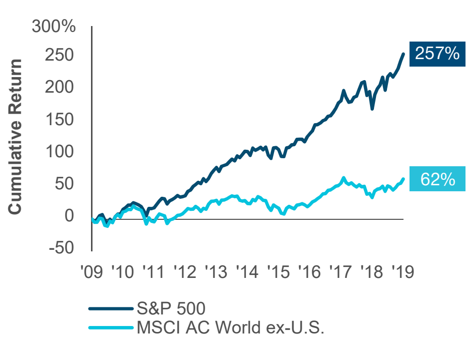
### Un-pricing a Recession

The U.S. yield curve has reached its steepest level since October 2018 as investors continue to gain confidence in the growth outlook amid waning concerns about trade. In fact, yield curves around the world are showing signs of re-steepening as investors begin to shed lower-yielding assets for riskier ones. The curve steepening reflects a reversal of the safe-haven trade we saw in August that drove the U.S. yield curve into inversion, a common predictor of a recession. Although consensus is not calling for a full-blown reflation trade at this stage of the cycle, investors' appetite for sectors that benefit from higher rates, like financials, has increased alongside inflation protected securities. Further improvement in sentiment and growth could lead to a continued repricing higher of inflation and rate expectations. However, there remains no shortage of global risks entering 2020, notably unresolved trade issues, tensions in the Middle East, and the upcoming U.S. presidential election.

### Show Me the Earnings!

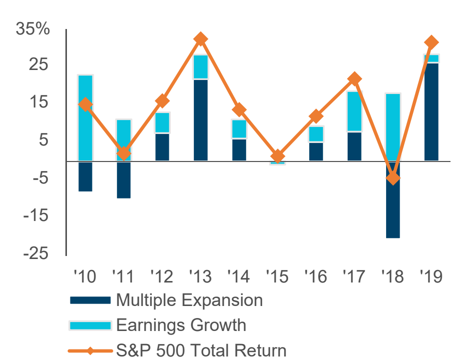
After 2018's tumultuous close to the year, U.S. stocks didn't look back throughout 2019, with the S&P 500 Index closing near record levels, up more than 31%. The stellar performance more than compensated for 2018's 4% loss, resulting in just over 12% annualized returns over the past two years. Despite flat earnings growth throughout 2019, stocks found support from improving trade negotiations and the Fed's success in engineering a "mid-cycle adjustment." With valuations back near 2018 highs, markets will likely look for earnings growth to sustain the recent momentum. Currently, earnings estimates for 2020 are slated for close to 10%. Although many investors are reluctant to buy into the optimistic estimates, further improvement in economic data and abating trade risk could spur corporate and consumer spending, making the current 2020 earnings growth rate of 10% not so far-fetched.

**U.S. vs. Global Ex-U.S. Equity Market Returns**
31 December 2009 to 31 December 2019
Figures are in USD




**U.S. Treasury Yield Curve Slope**
Difference Between 10Y and 2Y Yield
30 June 2018 to 31 December 2019


**S&P 500 Return Drivers**
Earnings Growth vs. Multiple Expansion
31 December 2009 to 31 December 2019




**Past performance is not a reliable indicator of future performance.**

Sources: Standard & Poor's, MSCI, Bloomberg Finance L.P., financial data and analytics provider FactSet. Copyright 2020 FactSet. All Rights Reserved. Please see "Additional Disclosures" on final page for information.

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# 3 Regional Backdrop

As of 31 December 2019

## United States

### Positives

- Fed likely on hold, inflation low
- Growth expected to stabilize
- Healthy consumer spending, strong employment, and improving wages
- Lower interest rates driving a modest rebound in housing
- Pause in trade war escalation
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

### Negatives

- Political uncertainty
- Modest economic growth upside
- Muted near-term earnings expectations
- Weak capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and corporate margins under pressure
- Elevated corporate and government debt levels

## Europe

### Positives

- Monetary policy remains very accommodative
- Services sector of the economy resilient
- Dividend yields remain strong
- Political uncertainty waning
- Indirect beneficiary of China stimulus

### Negatives

- Economic growth is challenged, with notable weakness in the manufacturing sector
- Limited scope for European Central Bank (ECB) to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains weak

## Developed Asia/Pacific

### Positives

- Stabilizing global economic outlook should be supportive for export-driven economies attractive valuations, particularly in Japan
- Improving corporate governance trends in Japan
- Fiscal stimulus enacted in Japan
- Australian housing market stabilizing

### Negatives

- Highly sensitive to global industrial production trends and trade tensions
- Market may be pricing in an unrealistic level of support from Bank of Japan and Reserve Bank of Australia
- Earnings growth remains tepid

## Emerging Markets

### Positives

- Muted (but rising) inflation, Fed has given central banks flexibility to ease
- Easing trade tensions
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle

### Negatives

- Instability in several key markets could weigh on sentiment
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused
- Commodity prices remain under pressure

# 4 Asset Allocation Committee Positioning

As of 31 December 2019

▼ or ▲ Month-Over-Month Change

**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**

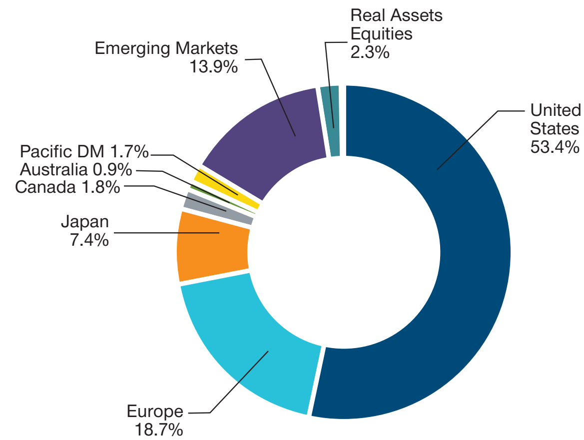
| | | Change | Underweight | Underweight | Neutral | Overweight | Overweight | |
|---|---|---|---|---|---|---|---|---|
| ASSET CLASS | Equities | ▲ | | | | ■ | | Above-average valuations with improving global growth sentiment and higher earnings expectations. |
| ASSET CLASS | Bonds | ▼ | | ■ | | | | Yields off recent lows on improving growth and inflation expectations, yet valuations remain extended. Credit spreads remain tight, with fundamentals broadly supportive. |
| ASSET CLASS | Cash | | | | ■ | | | U.S. cash yields less attractive post-Fed easing but remain higher than other developed markets. |
| EQUITIES | *Regions* | | | | | | | |
| EQUITIES | U.S. | ▼ | | ■ | | | | Valuations extended with margins under pressure; however, earnings expected to recover amid improving growth outlook. |
| EQUITIES | Global Ex-U.S. | ▲ | | | | ■ | | Central banks supportive and relative valuations attractive. Improving global growth backdrop supportive for cyclically oriented markets. |
| EQUITIES | Europe | ▲ | | | | ■ | | Growth outlook stabilizing but German manufacturing and banking system remain concerns. ECB continues to be supportive. |
| EQUITIES | Japan | ▲ | | | | ■ | | Monetary and fiscal policy supportive; export dependency and yen remain key drivers. |
| EQUITIES | Emerging Markets (EM) | ▲ | | | | ■ | | Fed on hold, cheap currencies, and China stimulus supportive; improving trade and growth outlook could provide tailwind. |
| EQUITIES | *Style* | | | | | | | |
| EQUITIES | U.S. Growth | | | | | ■ | | Secular growth companies less sensitive to macro environment; valuations remain elevated, and regulatory concerns are a risk. |
| EQUITIES | U.S. Value | | | ■ | | | | Valuations fair and could benefit near term on improving sentiment and higher interest rates; however, these catalysts are likely to be short-lived. |
| EQUITIES | Global Ex-U.S. Growth | ▼ | | ■ | | | | Valuations extended as sector has benefited from defensive characteristics. Improving growth could prove less favorable for higher-quality sectors. |
| EQUITIES | Global Ex-U.S. Value | ▲ | | | | ■ | | Valuations attractive with cyclical orientation and financials exposure likely to benefit from improving growth and higher rates. |
| EQUITIES | *Capitalization* | | | | | | | |
| EQUITIES | U.S. Large-Cap | | | ■ | | | | Valuations trending above historical averages, with earnings expected to rebound. Less likely to benefit from cyclical improvement as much as other sectors. |
| EQUITIES | U.S. Small-Cap | | | | | ■ | | Valuations attractive with cyclical tailwinds, but high leverage and wage pressure are risks. |
| EQUITIES | Global Ex-U.S. Large-Cap | | | | ■ | | | Central banks, stabilizing growth, and improved trade outlook supportive. |
| EQUITIES | Global Ex-U.S. Small-Cap | | | | ■ | | | Improving domestic growth trends and waning political uncertainty could provide support. |
| EQUITIES | *Inflation-Sensitive* | | | | | | | |
| EQUITIES | Real Assets Equities | | ■ | | | | | Improving global growth outlook supportive for commodities; however, structural oversupply remains a concern. |
| BONDS | U.S. Investment Grade (IG) | | | ■ | | | | Yields higher on growth improvement, but upside limited amid still low inflation. IG corporate spreads remain tight relative to history. |
| BONDS | Developed Ex-U.S. IG (Hedged) | | | | ■ | | | Central banks supportive and hedged U.S. dollar yields attractive, but durations remain extended. |
| BONDS | Inflation-Linked | | | | ■ | | | Inflation expectations rebounding from low levels amid improving growth sentiment. |
| BONDS | Global High Yield | | | | | ■ | | Yield carry attractive with near-term default expectations low. Vigilant on late-stage risks of credit cycle. |
| BONDS | Floating Rate Loans | ▲ | | | | ■ | | Yields remain attractive with limited new issuance and lower duration profile supportive. |
| BONDS | EM Dollar Sovereigns | | | | | ■ | | Yields remain attractive with central banks supportive; idiosyncratic/political risks remain sources of uncertainty. |
| BONDS | EM Local Currency | | | | | ■ | | EM currency valuation remains attractive; improving growth and a weaker U.S. dollar could provide tailwinds. |

# 5 Portfolio Implementation

As of 31 December 2019

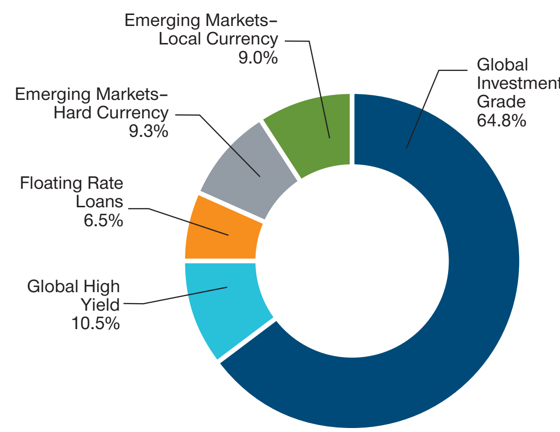
| Equity | Neutral Weight | Tactical Weight | Relative Weight |
|---|---|---|---|
| United States | 52.8% | 53.4% | +0.6% |
| Europe | 17.8 | 18.7 | +0.9 |
| Japan | 6.9 | 7.4 | +0.5 |
| Canada | 2.8 | 1.8 | -1.0 |
| Australia | 1.9 | 0.9 | -1.0 |
| Pacific – Developed Markets (DM) | 1.4 | 1.7 | +0.3 |
| Emerging Markets | 11.4 | 13.9 | +2.4 |
| 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% | 64.8% | -5.3% |
| Global High Yield | 10.0 | 10.5 | +0.5 |
| Floating Rate Loans | 5.0 | 6.5 | +1.5 |
| 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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**Equity risk –** in general, equities involve higher risks than bonds or money market instruments.
**Credit risk –** a bond or money market security could lose value if the issuer's financial health deteriorates.
**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.
**Small- and mid-cap risk –** stocks of small and mid-size companies can be more volatile than stocks of larger companies.
**Style risk –** different investment styles typically go in and out of favour depending on market conditions and investor sentiment.

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