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ASSET ALLOCATION INSIGHTS

Positioning for Recovery Amid Uncertainty

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KEY INSIGHTS

- The drivers of uncertainty are liquidity concerns, the spread of the virus, and the pandemic's impact on global economies.
- We are gradually adding to equities and increasing our exposure to credit sectors.

The current crisis is an unprecedented twin "black swan" event involving both a pandemic and a major shock in oil prices. The key factors driving uncertainty in this environment are liquidity concerns, the alarming spread rate of the contagion, and the pandemic's toll on global economies.

As panic selling across almost all assets accelerated, the Federal Reserve acted swiftly to stabilize markets and restore liquidity. However, some less liquid asset classes—those below investment grade—continue to be stressed. Meanwhile, the magnitude of the pandemic and its global economic impact continue to unfold, with unemployment increasing dramatically and a global recession looming.

In our multi-asset portfolios, we are gradually adding to equities. With attractive valuations and a favorable capital markets backdrop, we are incrementally closing our U.S. equities underweight. We are looking toward moderating our overweight to U.S. growth stocks, as we believe U.S. value stocks could be poised for a more pronounced rebound once volatility abates. Despite recent underperformance, we remain overweight to U.S. small-caps as they could be one of the best-performing sectors in a recovery.

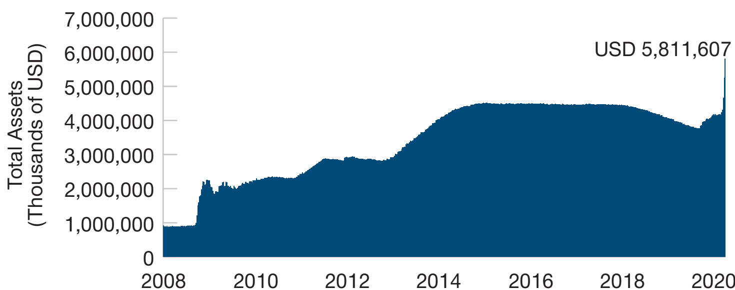
In fixed income, we are adding to credit sectors via high yield bonds and bank loans, which could potentially deliver equity-like returns postcrisis with lower overall volatility.

Until things stop getting worse, we expect a bumpy ride. Today's economy is not plagued by the structural challenges of prior recessions and is supported by unprecedented stimulus measures. An eventual easing of social distancing measures could potentially lead to a swift economic rebound, though a second wave of infection could complicate the recovery.

The Pandemic's Economic Impact and the Fed's Response

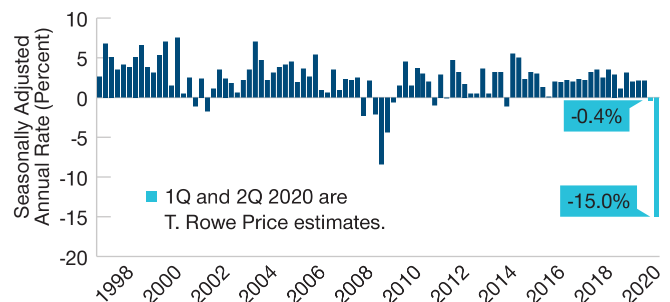
The Fed's stimulus measures provide a bridge as economic activity declines

Liquidity
U.S. Federal Reserve Balance Sheet



January 1, 2008, to April 3, 2020.
Sources: Bloomberg Finance L.P. and data analysis T. Rowe Price.

Economic Impact
U.S. Gross Domestic Product Growth



Quarterly, first quarter 1997 to fourth quarter 2019.
Source: Bureau of Economic Analysis/Haver Analytics.
Actual outcomes may differ significantly from estimates.

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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.

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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.

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Style Risk—Different investment styles typically go in and out of favour depending on market conditions and investor sentiment.

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