Global Asset Allocation Viewpoints

October 2020

1 Portfolio Positioning

As of 30 September 2020

Tipping Toward Value

- We remain neutral stocks versus bonds as we balance extended equity valuations against still ultra-low interest rates and the risk of upcoming political events, including the U.S. elections and Brexit.
- We shifted to a modest overweight in U.S. value-oriented equities as they may benefit from the gradual recovery in economic growth and attractive relative valuations versus growth-oriented equities.
- We maintain exposure to other areas that could benefit from cyclical acceleration including U.S. small-cap equities and emerging markets (EM) equities, as well as EM bonds and high yield.

2 Market Themes

As of 30 September 2020

Mounting Losses

Although unemployment rates have continued to decline, we are starting to see an alarming increase in permanent job losses, which has moved beyond service sectors. While initial hopes were that the impacts of the coronavirus would be short-lived, reality is setting in, and companies whose business models are most vulnerable to changes in consumer behavior are starting to cut headcount. With additional fiscal support potentially delayed until 2021, hard-hit areas of the economy may face irreparable damage. However, thus far consumer spending has remained healthy, and bankruptcies, while rising, have remained relatively modest, at least for now. Although signs of progress toward a vaccine have been promising, the likelihood of broad distribution could take many more months, placing further pressure on vulnerable areas of the economy. Without additional stimulus to bridge the gap, we may see a continued increase in job losses, particularly in the service sectors, reaching deeper into the economy and threatening the nascent recovery.

Waves of Uncertainty

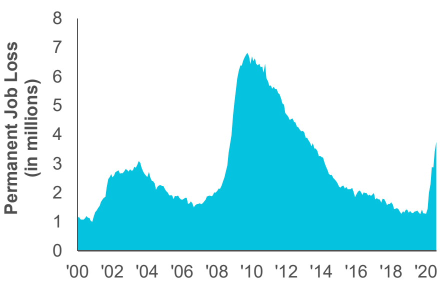
After getting through the first surge of coronavirus infections, Europe is now facing a second wave, forcing new restrictions to be imposed in areas that were well into reopening. The UK has been hit particularly hard by the second wave, seeing virus cases creep back up past May levels, reigniting discussions about a national lockdown. The challenges of containing this second wave come at a time when tensions surrounding Brexit are peaking, further complicating the region's outlook. While the UK officially exited the European Union (EU) last year, the two parties have failed to agree on important remaining issues surrounding trade and security, particularly regarding border checks between Ireland and the UK. With the EU being the largest trading partner of the UK, if an agreement is not in place by the end of the year, it could jeopardize an estimated trillion euros worth of annual trade. As the rest of the world recovers, Europe could be at risk of being left behind if it is not able to overcome these issues.

A November to Remember?

With a quickly approaching U.S. presidential election that is too close to call, mounting controversy surrounding mail-in ballots, the potential for a protracted legal battle, and the president's recent coronavirus diagnosis, markets are increasingly pricing in expectations of higher volatility that could last well beyond election day. Some believe that the potential for political chaos and prolonged uncertainty could be a bigger risk to the markets than the actual selection of either candidate. These fears are evident by the increasing costs of hedging against volatility post-election through November and December VIX futures. The markets' reaction to the more than a month of uncertainty during the 2000 election saw the S&P 500 down over 4%, 10-year Treasury yields falling over 50 basis points, and gold prices soaring over 12%. If the balance of power remains in flux for a longer period this time around, markets could be more vulnerable given extended valuations, a still tenuous economic recovery, and uncertainty around the coronavirus.

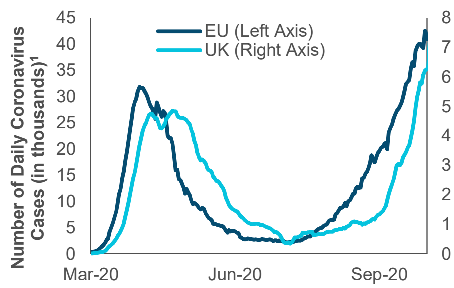
U.S. Unemployment: Permanent Job Loss

As of 30 September 2020



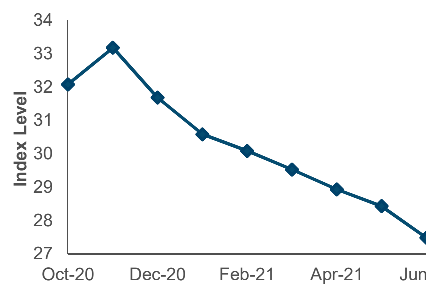
Second Wave in EU/UK

As of 30 September 2020



VIX[2] Futures Curve

As of 2 October 2020



Past performance is not a reliable indicator of future performance.
Sources: Bloomberg Finance L.P., Bloomberg Services Limited., Johns Hopkins University. Please see additional disclosures on the final page.
[1] Number of daily coronavirus cases represents the 7-day moving average of the number of daily cases in the region.
[2] VIX represents CBOE Volatility Index (VIX).
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3 Regional Backdrop

As of 30 September 2020

United States

Positives

- Unprecedented levels of monetary and fiscal support
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world
- Healthy consumer balance sheets prior to the crisis

Negatives

- Heightened political tensions
- Elevated corporate leverage going into the crisis
- Elevated government debt levels
- U.S. dollar strength has faded

Europe

Positives

- EU recovery fund provides further fiscal stimulus and is an initial step toward a fiscal union
- Monetary policy remains very accommodative
- Equity valuations are inexpensive
- Strong euro outlook

Negatives

- Lower share of secularly advantaged companies
- Banking sector was weak going into the crisis
- Weak economic growth going into the crisis
- Limited scope for European Central Bank to stimulate further
- Second wave of virus ongoing

Developed Asia/Pacific

Positives

- Outbreaks in this region have thus far been milder than in the rest of the world
- Strong fiscal and monetary support
- Smooth political transition gives hope that reforms will continue

Negatives

- Weak economic growth going into the crisis, driven by long-term demographic headwind
- Highly sensitive to global industrial production, trade trends, and natural resource prices, which have improved but remain low
- Experiencing a weaker recovery than other developed markets

Emerging Markets

Positives

- Chinese economy has largely rebounded
- U.S. dollar strength has eased
- Dovish Fed has helped ease financial conditions
- Equity valuations attractive relative to developed markets

Negatives

- Virus spread still increasing in some areas
- Limited ability to enact fiscal stimulus (excluding China)
- Highly sensitive to global industrial production and trade trends, which have improved but remain muted

4 Asset Allocation Committee Positioning

As of 30 September 2020

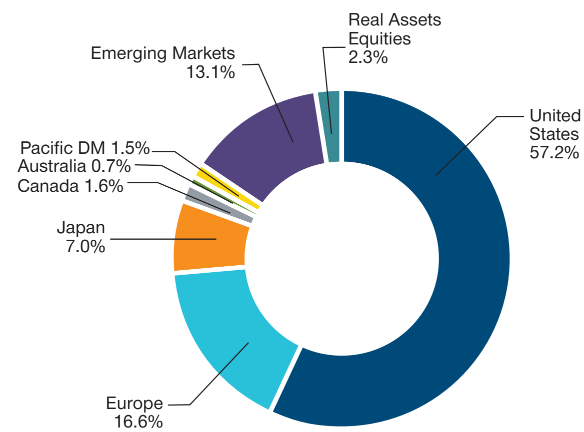
▼ or ▲ Month-Over-Month Change

		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				■			Elevated valuations reflecting optimistic pace in earnings recovery. Fiscal and monetary stimulus are key supports amid still nascent economic recovery.
ASSET CLASS	Bonds				■			Short-term yields remain anchored amid central bank pledges of support. Longer rates vulnerable to moving higher on improving growth. Spreads attractive within some credit sectors.
	Regions							
EQUITIES	U.S.				■			Defensive sector profile supportive despite extended valuations. Fiscal and monetary stimulus providing backstop and improved sentiment around earnings.
EQUITIES	Global Ex-U.S.				■			Economies outside the U.S. showing signs of improvement. Aggressive stimulus measures and rebound in Chinese demand are supportive. Second wave in Europe a risk to the region.
EQUITIES	Europe				■			Cyclically oriented sector profile and fiscal support could provide tailwinds. Second wave, limited tech representation, and poor environment for financials remain reasons for caution.
EQUITIES	Japan				■			Successful transition to new prime minister signaling continued fiscal and monetary stimulus support and reform efforts remain in place. Trade weakness remains a significant concern.
EQUITIES	Emerging Markets (EM)					■		Chinese economic strength and weaker U.S. dollar supportive. Less hampered by low rate environment. Most countries have limited stimulus levers to offset coronavirus weakness.
	Style							
EQUITIES	U.S. Growth	▼		■				Vulnerability to extended valuations, narrow leadership, and improving growth outlook could drive rotation toward more cyclical companies. Earnings trends remain supportive.
EQUITIES	U.S. Value	▲				■		Value equities could benefit from early stages of recovery. Relative valuations extremely supportive versus history. Support from higher rates and energy prices remains elusive.
EQUITIES	Global Ex-U.S. Growth				■			More defensive profile with greater weights in staples and health care, less susceptible to economic weakness, but valuations remain elevated.
EQUITIES	Global Ex-U.S. Value				■			Low rates and auto industry challenges remain headwinds. Some cyclically oriented value sectors, such as discretionary, energy and materials are showing signs of repair.
	Capitalization							
EQUITIES	U.S. Large-Cap			■				Larger companies better positioned to weather weaker growth environment but could lag as recovery advances due to extended valuations.
EQUITIES	U.S. Small-Cap					■		Relative valuations attractive and could offer upside potential as the recovery advances. Vulnerable to pull back in consumer spending, which could exacerbate bankruptcy risk.
EQUITIES	Global Ex-U.S. Large-Cap				■			Economic weakness, secular challenges, and low rate environment weighing on earnings outlook. However, valuations reflect these headwinds.
EQUITIES	Global Ex-U.S. Small-Cap				■			Vulnerable to consumer retrenchment in economies with less balance sheet flexibility. However, less exposure to banking system, and idiosyncratic opportunities are plentiful.
	Inflation-Sensitive							
EQUITIES	Real Assets Equities		■					Supply/demand dynamics for natural resources have improved, but transition to renewables is an overhang for entrenched players. Commercial real estate remains under pressure.
BONDS	U.S. Investment Grade (IG)					■		Nominal Treasury yields remain at low levels despite signs of improving growth and rising inflation expectations.
BONDS	Developed Ex-U.S. IG (Hedged)					■		Yields anchored by aggressive central bank response to coronavirus-related economic weakness. Hedged yield advantage less pronounced with narrow yield differential.
BONDS	U.S. Treasury Long		■					Yields remain range-bound near record lows with extended duration and are vulnerable to steepening at the long end of the yield curve should growth expectations improve.
BONDS	Inflation-Linked				■			Inflation expectations could continue to rise amid improving growth outlook and seemingly unlimited monetary and fiscal support.
BONDS	Global High Yield					■		Credit spreads remain at attractive levels. Cautious on downgrade/default risks. Impacts of virus outbreak could weigh on consumer-related and energy sectors.
BONDS	Floating Rate Loans					■		Yield spreads remain attractive, although Fed anchored at zero rate level. Relative to high yield bonds, less exposure to energy sector and higher in capital structure.
BONDS	EM Dollar Sovereigns					■		Sector offers attractive yield versus developed markets; however, relative valuations less attractive after recent rally.
BONDS	EM Local Currency					■		Valuations remain attractive with supportive developed market central banks and potential for weaker U.S. dollar.

5 Portfolio Implementation

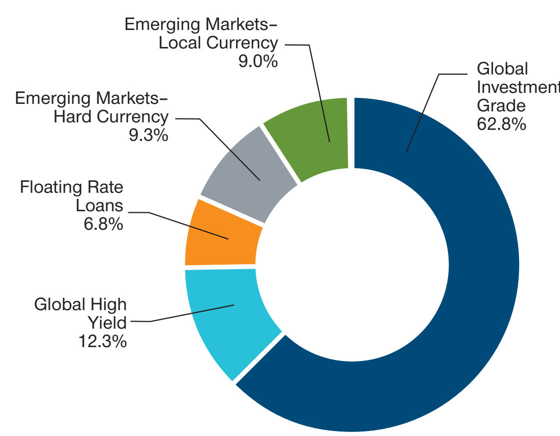
As of 30 September 2020

Tactical Allocation Weights



Equity	Neutral Weight	Tactical Weight	Relative Weight
United States	55.1%	57.2%	+2.2%
Europe	16.1	16.6	+0.6
Japan	6.7	7.0	+0.3
Canada	2.6	1.6	-1.0
Australia	1.7	0.7	-1.0
Pacific – Developed Markets (DM)	1.2	1.5	+0.3
Emerging Markets	11.7	13.1	+1.4
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%	62.8%	-7.3%
Global High Yield	10.0	12.3	+2.3
Floating Rate Loans	5.0	6.8	+1.8
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%**	

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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Source for Bloomberg Barclays index data: Bloomberg Index Services Limited. Please see “Additional Disclosures” on final page for information.

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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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