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2022 Midyear Market Outlook

Transitioning to a New Paradigm

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2022 Midyear Market Outlook

Navigating Challenging Currents

Russia's invasion of Ukraine, COVID-19 lockdowns in China, higher energy prices, and rising interest rates could make the second half difficult.

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Arif Husain, CFA
Head of International Fixed Income and Chief Investment Officer

Sébastien Page, CFA
Head of Global Multi-Asset and Chief Investment Officer

Justin Thomson
Head of International Equity and Chief Investment Officer

INTRODUCTION

Adjusting to an Uncertain Future

> In volatile markets, active management can be your friend.
>
> — **Justin Thomson**
> *Head of International Equity and Chief Investment Officer*

Heading into the second half of 2022, higher inflation and rising interest rates remain the most serious threats to global financial markets, T. Rowe Price senior investment leaders say.

Russia's invasion of Ukraine has added fire to those risks by pushing food and energy prices sharply higher and further disrupting global supply chains.

This inflationary "shock on shock" has put more pressure on the U.S. Federal Reserve and other major central banks to tighten monetary policy, while making it more difficult for them to tame inflation without choking off economic growth, according to Sébastien Page, Head of Global Multi-Asset and Chief Investment Officer (CIO).

"The three biggest challenges for investors over the next few months will be inflation, inflation, and inflation," Page says. "It's the transmission mechanism for all the other risks we are facing."

The key question now is whether those risks will cause a sharp deceleration in growth or push major economies into full-blown recessions, dragging corporate earnings down as well, Page warns.

Beyond the cyclical risks, investors need to consider that global markets may have reached a structural inflection point—an end to the era of ample liquidity, low inflation, and low interest rates that followed the 2008–2009 global financial crisis (Figure 1).

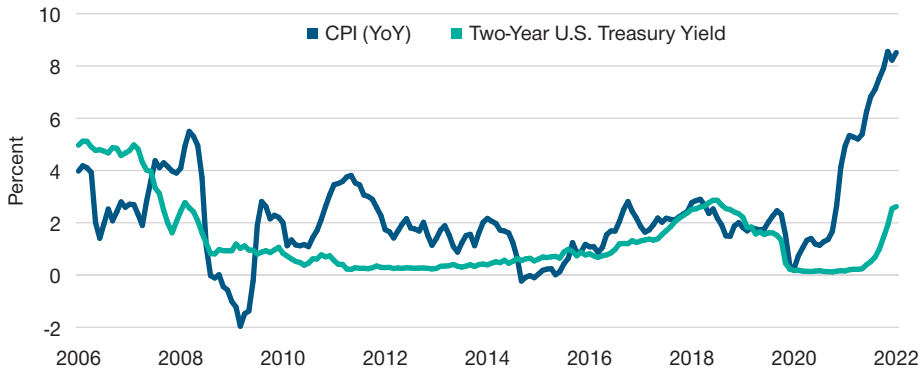
"I think that regime is over," says Arif Husain, Head of International Fixed Income and CIO. "You can throw away that playbook."

Central bank liquidity was critical for stabilizing economies and markets during both the financial crisis and the coronavirus pandemic, notes Justin Thomson, Head of International Equity and CIO. But it helped push valuations for many risk assets toward historical extremes. "I think we've learned from history that those extremes are never permanent," he says.

However, the new paradigm also could offer potential opportunities for investors with the skills and research capabilities needed to seek them out, Thomson adds. "In volatile markets, active management can be your friend."

The Era of Tame Inflation and Ample Liquidity Appears To Be Over

(Fig. 1) U.S. inflation* and the yield on the U.S. two-year Treasury note



May 31, 2006, through May 31, 2022.
*Inflation = year-over-year change in U.S. Consumer Price Index for All Urban Consumers.
Sources: U.S. Bureau of Labor Statistics and the Federal Reserve Bank of St. Louis.

THEME ONE

Navigating Challenging Currents

Inflation expectations are likely to dominate financial market performance in the second half of the year, just as they did in the first, the T. Rowe Price CIOs predict.

Although investors must contend with other economic headwinds—the war in Ukraine, COVID-19 lockdowns in China, and central bank tightening—inflation is the risk that channels those pressures into financial asset prices, Page argues.

- Higher energy and food prices in effect are a tax on the consumer, the main engine of global economic growth.
- With interest rates rising, continued earnings gains will be needed to support positive equity returns. But higher wage and input costs could cut into profit margins.
- Inflation raises the risk that the Fed will hike rates too aggressively, increasing the cost of capital and causing a recession.

"Those are three ways in which inflation can trigger a growth shock," Page says.

The key questions investors face now are whether inflation has already peaked, and, if so, whether it will decelerate quickly enough to limit the need for a prolonged monetary tightening campaign by the Fed.

While there have been some anecdotal signs in some markets that price pressures are easing—such as a slowdown in home price appreciation and cooling demand for labor—clearer evidence is needed, Husain argues. "Until we see a meaningful decline in inflation toward the targets that central banks have set, the burden of proof hasn't been met," he says.

How Will Central Banks Respond?

Even if inflation has peaked, fixed income investors appear unconvinced it will quickly return to the Fed's long-run target.

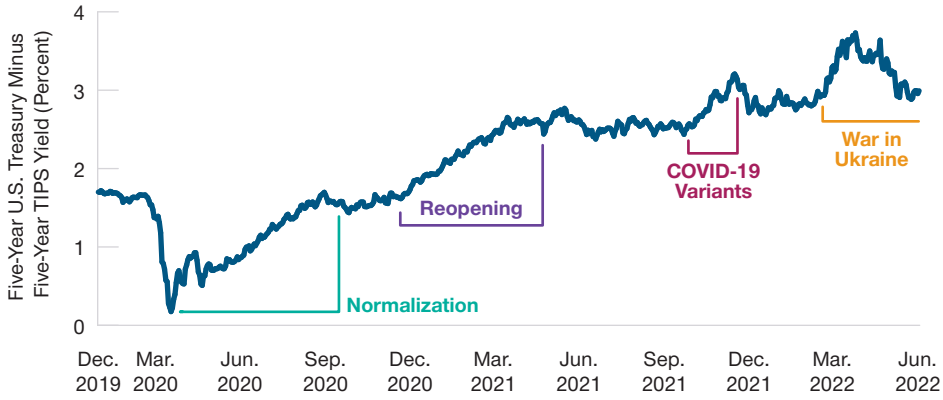
Figure 2 shows the spread, or breakeven, between yields on the nominal five-year U.S. Treasury note and on the five-year Treasury inflation protected security (TIPS). The breakeven is widely viewed as an estimate of investors' inflation expectations.

Although inflation expectations eased somewhat after surging in the wake of Russia's invasion of Ukraine, the breakeven remained close to 3% as of the end of May—almost a percentage point higher than the Fed's long-term target for the U.S. consumer price index (CPI).

"The market has already priced in a number of future Fed rate hikes, yet it still

Inflation Is Still the Key Issue for Global Investors

(Fig. 2) Five-year U.S. inflation expectations based on TIPS breakeven yields



December 31, 2019, through June 1, 2022.
Source: Bloomberg Finance L.P. Data analysis by T. Rowe Price.

> The question is whether fixing supply chains could do part of the Fed's job for it.
>
> **— Sébastien Page, CFA**
> *Head of Global Multi-Asset and Chief Investment Officer*

expects inflation to overshoot the Fed's target by a full percentage point per year over the next five years," Page comments.

With the CPI up more than 8.5% year over year through May, the market consensus also could prove too optimistic, Page says. "What if the CPI gets stuck on the way down at 4% or 5%?" he asks. "How committed is the Fed to its 2% target?"

The answers could be critical, and not just for the bond markets, Thomson says. "For global equity markets, the inflation outcome is absolutely key."

"If inflation settles around 3%, that could be a reasonable backdrop for equities," Thomson argues. "If it's between 3% and 4%, things could get a bit more difficult. But, if it's over 4% it could be [Paul] Volcker time"—a reference to the Fed chairman of the early 1980s who hiked rates to double-digit levels to break an inflationary spiral, pushing U.S. equities into a deep bear market.

The Supply Chain Factor

Inflation pressures are coming from both supply and demand and are being driven by both cyclical and structural factors, which makes the forecast exceptionally cloudy, Husain notes.

"I think what that means is that the Fed is going to keep raising rates," Husain says. "There will come a point where they'll want to pause and see what effect they are having. But my view is that we should be prepared for much higher rates going forward over the next few months."

Page suggests a possible silver lining to those clouds. There is plenty of potential "pent up" supply in the global economy, he argues, which could help bring inflation down if supply chain bottlenecks can be unclogged.

"The question is whether fixing supply chains could do part of the Fed's job for it," Page says. "If it happens soon enough, maybe they won't have to push demand off the cliff."

NAVIGATING CHALLENGING CURRENTS

Investment Idea	Rationale	Examples
Defensive Positioning in Equities	Market declines in the first half of 2022 modestly improved equity valuations. However, earnings growth in the second half could be challenged by slowing economies. Higher input costs also could cut into profit margins.	▪ Modest Equity Underweight
Inflation-Sensitive Equities	While inflation rates are expected to slow from recent peaks, lingering supply chain bottlenecks and strong demand for goods, services, labor, and housing could keep upward pressure on prices.	▪ Real Assets Equities ▪ Natural Resource Equities

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THEME TWO

Fundamentals Matter

A brutal spike in bond yields largely drove global equity losses in the first half of the year. In the second half, stock market performance is likely to depend on the outlook for corporate earnings growth.

After spending most of 2021 in deep negative territory, Page notes, the real, or after-inflation, 10-year Treasury yield (as measured by the 10-year TIPS yield) turned positive at the end of April. Figure 3 (left panel) shows the effect this had on U.S. equity valuations, which fell closer toward the middle of their recent historical range.

Now, Page says, with growth concerns rising, the focus is shifting to the "E" side of the price/earnings (P/E) ratio. "Everybody's wondering if this will be the next shoe to drop."

Although earnings momentum sagged in many non-U.S. markets in the first half, earnings per share (EPS) growth in the U.S. remained surprisingly steady (Figure 3, right panel). But Page says he doesn't believe this strength will last. "I think U.S. earnings are likely to decelerate in the second half, challenged by slowing economic growth," he predicts.

Supply chain improvements also could impact earnings—but maybe not in a good way, Page says. While moving more products might boost sales and revenues, it also could limit pricing power and eat into profit margins.

Sector and Style Leadership

Poor earnings environments historically have tended to favor the growth style, which typically is less threatened by cyclical downturns. But, Thomson says, this time could be different, given the heavy weight the technology sector now carries in the growth universe.

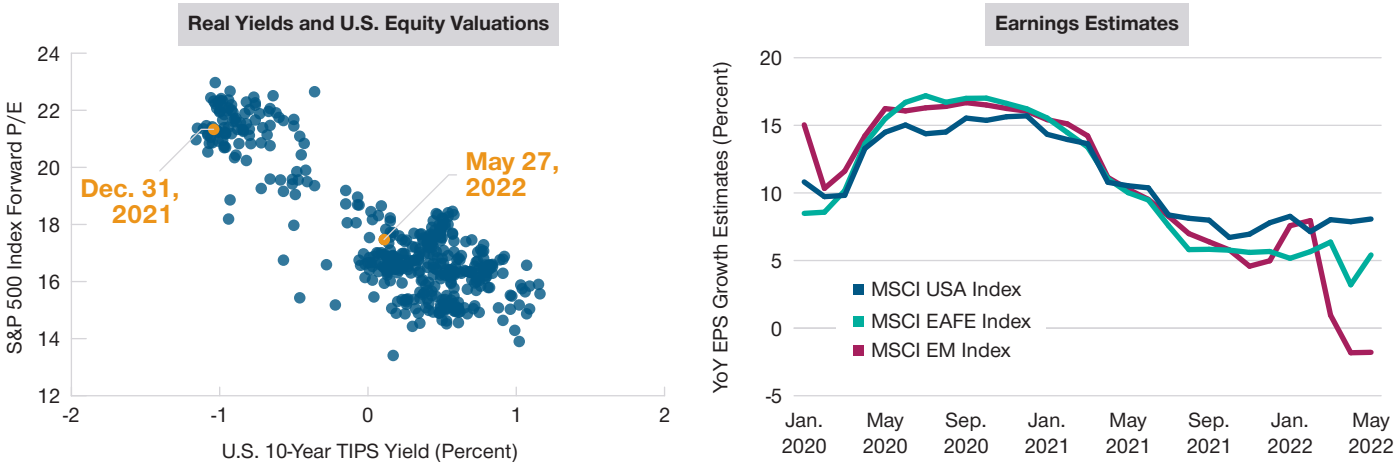
"The pandemic really did pull forward digitization, so we're going to be lapping some very strong 2021 earnings comparisons in the second half," Thomson explains. "We're also seeing some late-cycle effects that are detrimental to tech, such as skill shortages and salary inflation."

Consumer-oriented technology platforms, such as streaming media, also could be exposed to a cyclical slowdown in spending, he adds.

These factors suggest that the back-and-forth style rotations seen since

The Balance of Equity Risks Is Shifting From Interest Rates to Earnings Growth

(Fig. 3) S&P 500 Index forward P/E vs. 10-year Treasury real yield and 2022 EPS growth estimates in USD



P/E versus real yields from January 3, 2014, through May 27, 2022. EPS estimates from January 31, 2020, through May 31, 2022.
Sources: Haver Analytics/U.S. Bureau of Economic Analysis, Federal Reserve Bank of Dallas, MSCI, and T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved (see Additional Disclosures).

> A shift in market leadership appears to be underway. As we've seen from history, these cycles have tended to last a long time.

— Justin Thomson
Head of International Equity and Chief Investment Officer

the pandemic recovery have tipped in favor of value. "A shift in market leadership appears to be underway," Thomson says. "As we've seen from history, these cycles have tended to last a long time."

China Could Offer Opportunities

With the Morgan Stanley Capital International (MSCI) China Index down almost 50% from its early 2021 peak as of the end of May, Chinese equity valuations appeared potentially attractive, Thomson suggests. However, Beijing's "zero COVID" strategy has been a key obstacle to a growth revival.

"China has the capacity to stimulate," Thomson observes. "But there's no point in stimulating while locking down. It's like stepping on the accelerator and the brake at the same time."

How effectively Chinese policymakers will be able to boost growth in the second half is not yet clear, Thomson says. In addition to the coronavirus, sagging property values and credit defaults also could challenge any stimulus efforts.

That said, Thomson adds, in a world where many central banks are withdrawing liquidity to fight inflation, and governments in many developed countries are running deep fiscal deficits, China at least has scope to focus policy on supporting growth.

Another key factor for Chinese equities in the second half could be the regulatory climate, Thomson says, including Beijing's treatment of the country's domestic technology platform companies and its crackdown on foreign depositary receipt listings.

Thomson says he believes regulatory policies are likely to turn more market friendly in the runup to the Chinese Communist Party's 20th Party Congress later in the year. "This regulatory cycle has been particularly drawn out and deep," he says. "But we believe these issues will get better from here."

Thomson says he's reluctant to predict a leadership shift to non-U.S. equities in the second half, given the U.S. market's extended outperformance over the past decade. However, if the U.S. dollar appreciation seen in the first half subsides, and the technology sector continues to struggle, the relative performance of non-U.S. equity markets should at least improve, he says.

FUNDAMENTALS MATTER

Investment Idea	Rationale	Examples
Less-Rate-Sensitive Equities	Higher interest rates potentially could favor some value sectors, including financials. The growth style could be challenged by tough year-over-year earnings growth comparisons and continued weakness in the technology sector.	▪ Value Stocks
Faster Growth in China and Other Emerging Markets	China is expected to use economic stimulus to speed its recovery from COVID-19 lockdowns. Reopenings and less restrictive regulatory policies could support Chinese equities and help boost growth in other emerging markets.	▪ Chinese Equities ▪ Emerging Market Equities

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THEME THREE

Flexible Fixed Income

U.S. Treasuries and other developed sovereign bonds did an exceptionally poor job of offsetting equity volatility in the first half. This suggests that investors may need to expand their search for diversification across fixed income sectors and geographic regions.

A key question, Page says, is whether the spike in stock/bond correlations seen in early 2022 was just temporary or reflected a structural "regime change" that could keep correlations high for an extended period. If the latter explanation is correct, alternatives to the traditional 60/40 stock/bond allocation that include dynamic hedging and other defensive strategies could offer advantages to some investors.

Stock/bond correlations have switched from positive to negative several times in recent years, Page notes (Figure 4). T. Rowe Price research suggests that these shifts typically were caused by economic shocks—sudden spikes in unemployment, inflation, or interest rates.

"I think Treasuries still have a role to play in portfolio allocations—especially if the next leg of the crisis is a recession," Page says. "But I also think investors are going to want to consider other approaches to downside risk mitigation."

Is It Time to Extend Duration?

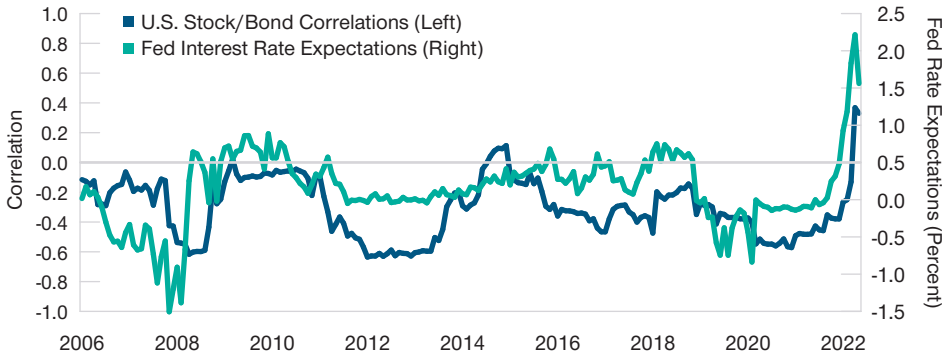
A more immediate issue for fixed income investors is whether bond yields have reached a near-term peak, creating a potential opportunity to lock in portfolio income.

"In our view, this is the most attractive point to buy bonds that we've seen for several years," Husain says. "We think that over the next several quarters investors may want to consider adding duration."

However, Husain also predicts that the Fed will continue tightening until it has pushed its key market rate, the federal funds rate, into positive territory in after-inflation terms. With the nominal fed funds rate still under 1% at the end of May, that would seem to leave considerable room for further rate hikes. As of early June, he adds, "I don't think we're quite at the peak for yields."

In a Rising Rate Environment, Bond Investors May Need More Diversification

(Fig. 4) Fed rate expectations vs. U.S. stock/bond correlations*



Past performance is not a reliable indicator of future performance.
January 2006 through May 2022.
*Fed interest rate expectations = yield on two-year Treasury note minus federal funds target rate. U.S. stock/bond correlations = rolling two-year correlation of monthly price changes for the S&P 500 Index and the 10-year U.S. Treasury futures contract.
Sources: Standard & Poor's, J.P. Morgan North America Credit Research (see Additional Disclosures), and Bloomberg Finance L.P. Data analysis by T. Rowe Price.

> Over the medium term, I think yields will reach levels that will make clients happy with the income they're getting from their bond portfolios.
>
> **— Arif Husain, CFA**
> *Head of International Fixed Income and Chief Investment Officer*

For U.S.-based investors worried about rising rates, global markets could offer diversification potential, Husain suggests. While the Fed is tightening, other countries are further along in their interest rate cycles. Some have stopped raising rates. Others have even started cutting them.

"By taking advantage of monetary policy divergence, investors can seek to diversify their interest rate exposures on a currency-hedged basis," Husain explains. Recent valuation levels potentially make emerging markets (EM) U.S. dollar bonds particularly attractive, he adds, although both country selection and underlying security selection will be critical.

The Upside Potential of Higher Yields

If yields do continue to rise, Husain says, at some point they should reach levels that offer attractive income opportunities for investors who understand how to manage duration—or who can rely on skilled investment professionals to do it for them. "Over the medium term, I think yields will reach levels that will make clients happy with the income they're getting from their bond portfolios," he says.

Some credit sectors, such as high yield corporate bonds, may have reached that point, Husain suggests. "Looking at the high yield universe, I've seen yields in the 7% to 8% range, in some cases," he says. "I've seen some BB rated bonds priced at 80 cents on the dollar. Those are levels that historically have proven to be good buying points."

The caveat to the bullish case for high yield is the uncertain economic outlook, Husain notes. As of May, high yield default rates remained near historical lows, and rating upgrades were more than twice as high as downgrades. But a growth shock could quickly change that picture.

"The threat of recession is real," Husain cautions. "So investors need to do their homework." For T. Rowe Price fixed income portfolio managers, he adds, this will mean relying on the firm's extensive research capabilities and independent credit ratings to help navigate risks.

In volatile markets, duration management and yield curve positioning also could be important tools for managing risk, Husain suggests. "Fixed income is a relatively liquid asset class, so I would argue that investors could potentially benefit by using that liquidity to stay active," he says.

FLEXIBLE FIXED INCOME

Investment Idea	Rationale	Examples
Globally Diversified Bonds	While the Fed and other major central banks are tightening, not all countries are at the same point in their monetary cycles. By taking advantage of divergence, investors may be able to diversify interest rate exposure.	▪ Dynamic Bond Allocation Strategies
High Yield Income	Higher interest rates and wider credit spreads (the additional yield over comparable U.S. Treasuries for bonds with credit risk) potentially create income opportunities for investors with the appropriate time horizons.	▪ Global High Yield Bonds

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THEME FOUR

Managing Through Geopolitical Risks

Russia's invasion of Ukraine has shaken the global political landscape. Beyond the destruction and human suffering inflicted by the war itself, the conflict threatens to worsen hunger in the world's poorest countries, spur a new arms race, and block cooperation on problems like climate change and nuclear proliferation.

While those shocks could be felt for years, the consequences for global markets were more immediate:

- Economic sanctions on Russia and the closure of Ukraine's ports on the Black Sea sent prices of key commodities soaring (Figure 5, left panel).
- Fears about the impact on Europe's economies pushed the euro and the British pound sharply lower against the U.S. dollar.
- Financial sanctions made Russian equities essentially uninvestable for foreign investors and pushed Russia's foreign currency debt to the brink of default.

The war's inflationary impact will be magnified in the developing world, where food products typically have a much heavier weight in consumer price indexes than in the developed world (Figure 5, right panel).

"Not only are Russia and Ukraine the breadbaskets of Europe," Husain says, "but they export many of the chemicals that go into fertilizers and other agricultural inputs around the world."

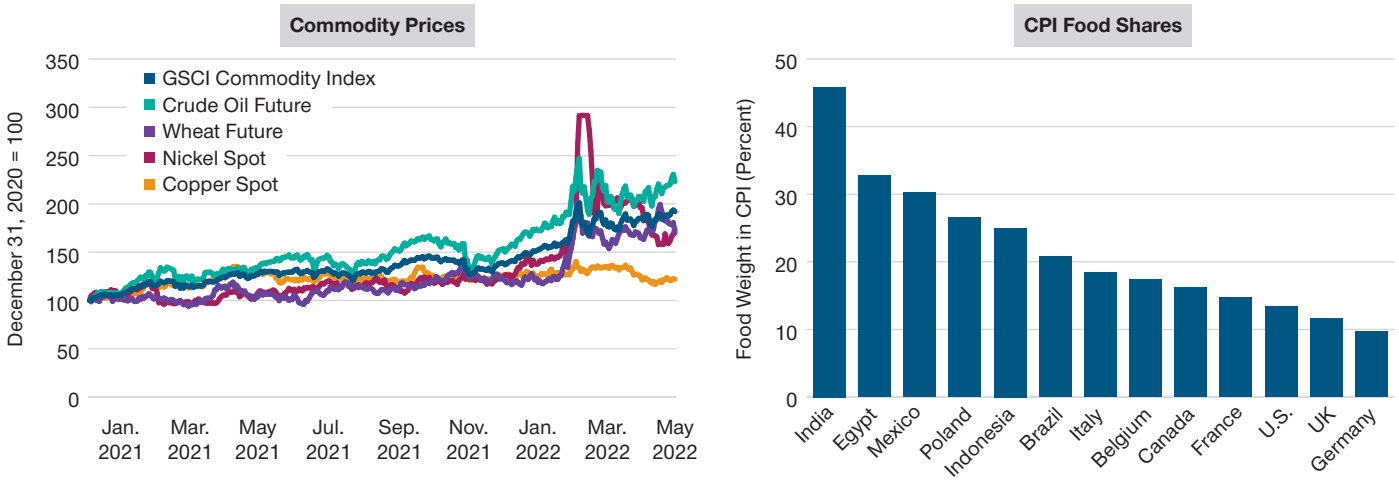
The war also has exposed Europe's overdependence on Russia for oil and natural gas supplies, Thomson says. This will have implications not just for energy security, but for issues related to energy equity—such as consumer subsidies.

Disappointing financial performance in the oil and gas sector had led many equity investors to underweight energy stocks heading into this year, Thomson notes. But the Russian invasion was a wake-up call.

"I think the market suddenly realized that energy is a strategically important sector and that we've probably been undervaluing it," Thomson says. "A lot of portfolios are feeling the consequences."

The War in Ukraine Is Feeding Commodity Inflation Worldwide

(Fig. 5) Price changes for select commodities and weight of food in national consumer price indexes



Past performance is not a reliable indicator of future performance.

Commodity prices from December 31, 2020, through May 31, 2022. Food price shares as of March 31, 2022.

Sources: Haver Analytics/J.P. Morgan (see Additional Disclosures) and T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved.

> As the saying goes, the cure for high prices is high prices—in this case, high prices for hydrocarbons.
>
> **— Justin Thomson**
> *Head of International Equity and Chief Investment Officer*

A Boost for Renewable Energy

Like most economic disruptions, the energy shock has the potential to create investment opportunities as well as risks. The transition to renewable energy sources, such as wind and solar, could be one of them, Thomson suggests.

"As the saying goes, the cure for high prices is high prices—in this case, high prices for hydrocarbons," Thomson argues. "It reduces the relative costs of switching to other sources, so the transition to renewable energy should accelerate."

Higher oil and gas prices also could spur investments throughout the energy supply chain, not just in renewable projects such as wind and solar farms, Thomson adds. This could include upgrading electrical grids and developing more efficient energy storage technologies—which in turn could boost demand for the raw materials used in those projects.

The Impact of Sanctions

The financial penalties imposed on Russia in response to the invasion could accelerate another longer-term transition—toward a less centralized global financial system, Husain contends.

The initial round of sanctions included several unprecedented steps, such as freezing Russia's foreign currency reserves at the Fed and other cooperating central banks and banning some Russian banks from the SWIFT (Society for Worldwide International Financial Telecommunications) financial messaging system.

While these measures have imposed heavy costs on Russia, they also could motivate other countries to seek alternatives to an international payments system dominated by the U.S. and the other major financial powers.

"Some countries may be looking at this and thinking, 'We need to find another way of moving our money and transacting on a global basis,'" Husain says.

As long as sanctions remain limited to Russia and its closest allies, they appear to pose limited risks to the global economy. But that might not be the case if secondary sanctions were imposed on other countries, particularly China, in response to actions perceived as aiding the Kremlin's war effort.

"The biggest unknown here for Chinese markets is geopolitical risk," Thomson says. "If there is a further spillover from Russia's invasion, and the Western democracies extend sanctions to China, then we would be in a very difficult situation."

Although secondary sanctions on China appear to be a "tail" risk—i.e., a relatively low-probability outcome—that risk is likely to weigh on Chinese equity valuations in the second half, Thomson adds.

MANAGING THROUGH GEOPOLITICAL RISKS

Investment Idea	Rationale	Examples
Energy Infrastructure	The war in Ukraine has pushed oil and gas prices higher. This could accelerate the shift to renewable energy sources and boost investment in electrical grids and new energy storage technologies.	▪ Global Industrials ▪ Sustainable Investing

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Summary

> You only truly understand your risk tolerance during regime shifts.
>
> — **Sébastien Page, CFA**
> *Head of Global Multi-Asset and Chief Investment Officer*

The shocks inflicted on markets in the first half of 2022 required global investors to adjust their expectations for inflation, interest rates, earnings growth, and volatility. But a longer-term adjustment also may be necessary, the T. Rowe Price CIOs say.

"We are in the midst of a paradigm shift here," Thomson says. "We're moving from a low-yield, low-inflation, low-volatility environment to one of higher inflation, higher rates, and probably higher volatility."

New conditions may force many investors to unlearn some old ideas, like the notion that the Fed and/or the other major central banks can be counted on to pump liquidity into the markets if asset prices fall too far or too fast—a concept popularly known as the "Fed put."

Now, "the Fed put is either gone or deeply out of the money," Page says. If anything, he argues, investors face the potential for a "Fed call." If risky assets rally too exuberantly in the second half, an inflation-wary Fed might respond by hiking interest rates more aggressively, choking off any rebound.

Lessons From the Past

Previous paradigm shifts offer some unsettling examples of markets caught off guard either by valuation excesses or external shocks—or both, Thomson says. These past episodes include:

- The 2000–2002 dot-com crash, which illustrated the enduring importance of basic valuation fundamentals like cash flow and earnings.
- The highly concentrated U.S. large-cap market of the early 1970s, which was slammed by oil supply shocks and rampaging inflation.

But history doesn't have to repeat, Thomson observes. "The way central banks are dealing with inflation is more sophisticated this time. I think that will lead to better outcomes than we saw for the duration of the 1970s."

But the new paradigm also will require investors to pay close attention to their time horizons and tolerance for risk.

"Risk tolerance doesn't usually get tested in normal times," Page cautions. "You only truly understand your risk tolerance during regime shifts."

Above all, we believe investors should understand the risks of remaining passive in a fast-changing market environment. Capitalization-weighted indexes may be poorly positioned for structural change, making skilled active management a critical tool for identifying risks and opportunities.

"In the middle of a paradigm shift, doing nothing can be a very dangerous thing," Husain says.

2022 Midyear Tactical Views

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		Despite the sell-off in the first half, stocks remain vulnerable to further weakness. Earnings expectations have held up reasonably well thus far but could face considerable pressure from rising input costs and slowing economic growth.
	Bonds		Tighter global central bank policies and still-elevated inflation could keep upward pressure on yields, although U.S. interest rates appear to have peaked for now. Credit spreads look more attractive following a period of risk-off sentiment.
			Equity Regions
EQUITIES	U.S.		An orientation to growth and relatively narrow leadership make the U.S. market more susceptible to rising rates. However, the lower representation of more cyclical sectors could be beneficial if recession concerns increase further.
	Global Ex-U.S.		Less challenging valuations and a procyclical sector profile could be supportive if the economic growth outlook stabilizes. However, a protracted war between Russia and Ukraine could weigh on the growth outlook and on global supply chains.
	Europe		Valuations are attractive, but the war in Ukraine poses significant risks, including rising energy costs and the impact of financial sanctions. The policy path for the European Central Bank (ECB) is likely to remain uncertain in coming months.
	Japan		Yen weakness and the Japanese market's cyclical orientation have been significant headwinds to performance. Attractive valuations, supportive monetary policy, and improving corporate governance could provide long-term tailwinds.
	Emerging Markets		Valuations are attractive overall. While COVID lockdowns remain a near-term headwind in China, the medium-term outlook for Chinese equities appears more positive due to prospects for more significant policy support.
			Style and Market Capitalization
	U.S. Growth vs. Value*		Relative valuations remain attractive for many value stocks, but the gap with growth has narrowed and the cyclical outlook has weakened. The stay-at-home tailwind for growth continues to fade, and valuations still are pressured by higher rates.
	Global Ex-U.S. Growth vs. Value*		Value stocks remain attractive, but cyclical tailwinds have weakened and geopolitical risks have increased. Meanwhile, growth stocks remain under pressure from higher relative valuations and potentially higher rates.
	U.S. Small- vs. Large-Cap*		Small-cap stocks offer attractive relative valuations and still-strong earnings growth, in our view. However, elevated input costs, wage pressures, and heightened market volatility could challenge performance. A quality bias appears warranted.
	Global Ex-U.S. Small- vs. Large-Cap*		Small-cap stocks balance idiosyncratic opportunities with moderating global growth. We believe caution is warranted due to U.S. dollar strength and the potential for a flight to quality that could favor large-cap stocks.
			Inflation Sensitive
	Real Assets Equities		Commodity prices already are elevated, but we believe supply shortages are likely to endure over the near to medium term. Commodities can offer an attractive hedge in sustained periods of elevated inflation.
BONDS	U.S. Investment Grade (IG)		The direction of rates will depend on the outlook for further Fed tightening in the face of moderating growth, potentially peaking inflation, and geopolitical conflicts. Wider credit spreads reflect risk-off sentiment.
	Developed Ex-U.S. IG (Hedged)		Central banks, such as the ECB, are expected to turn more aggressive, which could pressure rates higher. The U.S. dollar remains supported by Fed tightening and a flight-to-quality trade.
	U.S. Treasury Long		Longer-term rates appear to have peaked as expected Fed tightening is already priced in. The sector provides portfolio ballast in a risk-off scenario, but remains vulnerable if elevated inflation rates persist.
	Inflation Linked		Although inflation rates may be peaking, the sector still could offer benefits if stressed supply chains continue to push commodity prices higher and Fed tightening fails to bring inflation down.
	Global High Yield		Credit fundamentals still appear strong, and default rates remain low. Wider credit spreads in the wake of risk-off sentiment also are supportive. However, spreads could remain volatile due to geopolitical, inflation, and growth concerns.
	Floating Rate Loans		Relative valuations appear less attractive, but solid fundamentals and strong demand for yield are still tailwinds. However, shorter duration and frequent rate resets could be less beneficial as Fed tightening appears priced in.
	EM Dollar Sovereigns		Valuations look attractive, in our view, and are supported by moderating Fed expectations and stronger trade activity. However, geopolitical tensions, lingering coronavirus concerns, and fiscal pressures remain risks.
	EM Local Currency		Yields are attractive and many EM currencies appear relatively cheap, in our view. However, local currencies remain vulnerable to U.S. rate hikes, while Fed tightening and a flight to quality could keep upward pressure on the U.S. dollar.

*For pairwise decisions in style and market capitalization, boxes represent positioning in the first asset class relative to the second asset class.
The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalization asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

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