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Global Asset Allocation Viewpoints

November 2022

1 Market Perspective

As of 31 October 2022

- The outlook for the global economy remains uncertain as central banks navigate battling stubbornly high inflation in the face of weakening growth expectations.
- Taming inflation remains the US Federal Reserve's number one goal despite the risk of creating more economic pain. Energy-driven inflation gives the European Central Bank a more challenging task amid a divergence in fiscal flexibility across the Union's members. While having held steadfast, the Bank of Japan may be forced to ease yield curve controls as inflation has started taking hold.
- Emerging market central banks are ahead in the global tightening cycle but may need to hold rates high to defend weak currencies. In contrast, China eases policy to balance growth risk from COVID-lockdowns.
- Key risks to global markets include central bank missteps, persistent inflation, potential for a sharper slowdown in global growth, China's balance between containing the coronavirus and growth, and geopolitical tensions.

2 Portfolio Positioning

As of 31 October 2022

- We are underweight stocks as we remain cautious on the environment for equities given still-aggressive central bank tightening and a weakening outlook for growth and earnings.
- We remain modestly overweight cash relative to bonds given risk of higher rates weighing on bonds, while cash offers safety and more attractive yields given the push higher in short-term policy interest rates.
- Within equities, we are nearly balanced between value and growth. The slowing growth backdrop is unfavorable for cyclicals, while higher rates weigh on growth-oriented equities.
- Within fixed income we increased our high yield allocation, funding from floating rate loans, as most of the benefit from rising short-term rates has passed. High yield bonds yields offer reasonable compensation for risks while fundamentals remain supportive. Defaults rates are expected to rise from today's historically low levels, although yields at current levels help provide a buffer. We also hold a modest overweight to long-term US Treasuries as a risk-off ballast to equities.

3 Market Themes

As of 31 October 2022

When Bad News is Good

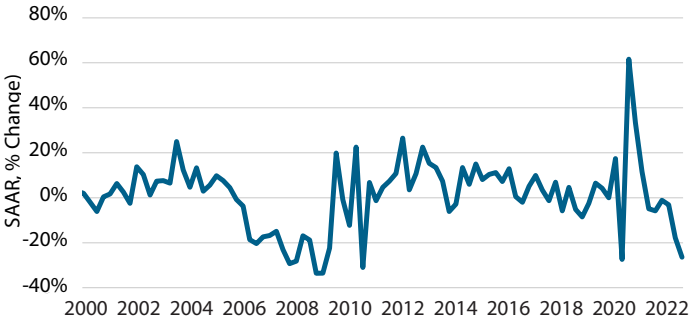
On the surface, the better-than-expected rebound in U.S. GDP growth in the 3rd quarter would reinforce the Fed's need to remain aggressive on tightening policy. However, looking at the details, there is growing evidence the economy is feeling the bite of sharply higher rates. Consumer spending, comprising nearly 70% of GDP, declined while residential fixed investment, a broad measure of housing activity, slumped by more than 26%. Consumer confidence data last month also flashed warning signs that consumers were increasingly concerned about the impact of high inflation and are growing worried about the job market ahead. Signs of slowing were seen in the October ISM Manufacturing index that fell to levels last seen in May 2020, although did show promising signs on the inflation front with supplier deliveries and prices paid easing. U.S. markets have responded positively to the batch of bad news, with U.S. Treasury yields easing and equity markets higher. While the Fed remains vigilant in their battle to fight inflation, evidence is building that their front-loaded rate hikes are having an impact, at least on growth and potentially preceding softer inflation data. Meanwhile, investors are likely to continue to cheer bad economic data in hopes it brings good news of a Fed pivot in policy.

Divided, We Rally?

U.S. markets have historically championed periods of divided government and with the mid-term elections imminent, polls suggest that may occur with increasing odds that Republicans take control of the House of Representatives - and the Senate now a toss-up. Amongst voters' top issues are record high inflation and slowing economy which are weighing on Democrats, whose two-year reign saw them advance progressive policies and spending that voters may now blame for fueling inflation. Historically, a divided government has been seen as a positive providing checks and balances of power, reducing the likelihood of extreme policies being passed and for legislation that does requiring more bi-partisan compromise. Similarly, uncertainty that impacts corporate and household spending plans eases as the likelihood of significant changes to spending, taxation, and regulatory policies ebbs. However, while gridlock may be welcomed by the markets, a divided government could raise the potential for volatility in other areas such as raising the debt ceiling limit, support for Ukraine, and regulation of the technology sector. China policy has been an area which has witnessed broader bipartisan agreement representing a potential risk to markets. So, while markets could rally on news of a divided government, we shouldn't expect political uncertainty to go away, particularly in today's world.

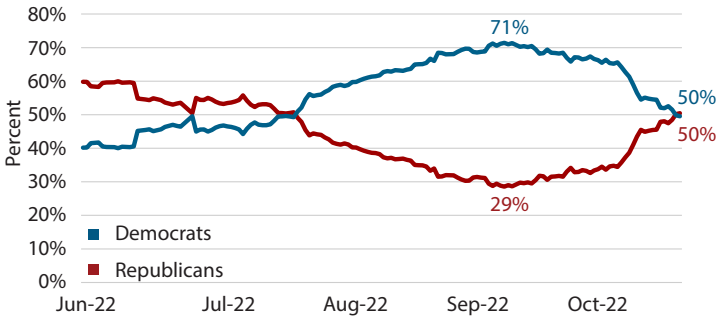
Real Private Residential Investment

As of 31 October 2022



Chances of Controlling the Senate

As of 31 October 2022



Source: Haver Analytics / Bureau of Economic Analysis.
Source: FiveThirtyEight.com

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4 Regional Backdrop

As of 31 October 2022

	Positives	Negatives
United States	▪ Strong corporate and consumer balance sheets ▪ Resilient labor market ▪ Supply chain issues improving rapidly	▪ Persistently high inflation ▪ Restrictive monetary policy ▪ Labor supply shortages ▪ Deteriorating corporate margins
Europe	▪ Fiscal spending likely to increase ▪ Very attractive equity valuations ▪ ECB sovereign bond-buying backstop	▪ Recession risk is very high ▪ Industrial production will be curtailed by energy shortages ▪ ECB is tightening ▪ Sovereign debt risks are rising ▪ Limited long-term catalysts for earnings growth
Developed Asia/Pacific	▪ Very attractive equity valuations ▪ Improving corporate governance ▪ Monetary and fiscal policy remains accommodative ▪ Low inflation relative to the rest of the world	▪ Limited long-term catalysts for earnings growth ▪ Global trade volumes are slowing ▪ Extreme Yen weakness due to interest rate differentials
Emerging Markets	▪ Chinese authorities are easing monetary and credit conditions ▪ Equity valuations are attractive relative to the US ▪ EM central banks further along in tightening cycle ▪ Attractive currency valuations	▪ Global trade volumes are slowing ▪ COVID policy remains a headwind to economic growth ▪ Chinese housing concerns have impacted industrial activity ▪ Chinese regulatory actions are weighing on confidence ▪ Geopolitical risks are elevated

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5 Asset Allocation Committee Positioning

As of 31 October 2022

Underweight — Neutral — Overweight

▼ or ▲ Month-Over-Month Change

		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.
ASSET CLASS	Equities		Stocks remain vulnerable amid tightening liquidity and a hawkish Fed. Earnings expectations are fading rapidly but remain elevated. However, valuations are at reasonable levels after falling considerably through the year.
	Bonds		The balance between central bank tightening, high inflation and deteriorating growth likely keeps rate volatility elevated. Credit sectors, such as high yield, offers attractive yields and fair spreads with supportive fundamentals.
EQUITIES	*Regions*		
	U.S.		US equities remain expensive on a relative basis. However, the less cyclical nature and stronger near-term outlook may provide some support as global growth weakens.
	Global Ex-U.S.		Inflation concerns, tighter central bank policy, an energy crisis in Europe, and continued strength of the U.S. dollar are notable headwinds. However, valuations are attractive on a relative basis.
	Europe		Valuations are compelling, but elevated energy costs and weakening manufacturing activity have made a recession highly likely. Meanwhile, the ECB is constrained in providing support with inflation concerns rising.
	Japan		Despite cyclical concerns, Japan offers historically cheap valuations, relatively lower inflation, accommodative monetary and fiscal policy, and improving corporate governance. Yen weakness has reached extreme levels but may face further weakness over the near term.
	Emerging Markets (EM)		Valuations and currencies are attractive. Central bank tightening may have peaked. However, the near-term outlook in China has deteriorated due to ongoing COVID lockdowns, housing market concerns, and geopolitical uncertainty.
	Style & Market Capitalization		
	U.S. Growth vs. Value[1]		Relative valuations for value stocks remain attractive, and energy sector earnings could provide support. However, the more cyclical nature of value stocks makes them more vulnerable if inflation concerns give way to increasing recession risks.
	Global Ex-U.S. Growth vs. Value[1]		Value stocks offer attractive valuations. However, they could face significant pressure as cyclical risks rise due to tightening monetary policy, sovereign debt concerns, and the European energy crisis.
	U.S. Small vs. Large-Cap[1]		Small-cap stocks offer historically attractive relative valuations, reflecting elevated recession concerns and the impact of higher financing costs. However, small-cap earnings have held up well thus far and could improve if the outlook stabilizes. Higher-quality bias is warranted.
	Global Ex-U.S. Small vs. Large-Cap[1]		Small-caps offer idiosyncratic opportunities and attractive valuations. However, caution is warranted due to US dollar strength and a potential flight to quality that could favor large-caps.
	Inflation-Sensitive		
	Real Assets Equities		Commodity prices may face further pressure due to economic concerns and waning demand—particularly from China. However, real assets offer an attractive hedge if inflation remains elevated.
BONDS	U.S. Investment Grade (IG)		Fed tightening and elevated inflation outweighing growth and recession concerns, resulting in continued rate volatility.
	Developed Ex-U.S. IG (Hedged)		Rates biased higher as developed market central banks, with the exception of the BoJ, remain hawkish as they continue to combat high inflation. The US dollar remains supported by the Fed's tightening and its function as a safe-haven asset.
	U.S. Treasury Long		The sector provides portfolio ballast in a more extreme risk-off scenario but remains vulnerable to persistently elevated inflation. US Treasury Long bonds are increasingly more attractive as rates move higher.
	Inflation-Linked		Breakevens remain volatile as inflation has stayed above expectations, the sector could offer protection if Fed tightening fails to bring inflation down.
	Global High Yield ▲		Credit fundamentals and the default outlook remain stable but may be challenged as economic growth continues to deteriorate. Higher yields offer reasonable compensation for risks, with spreads fairly valued and likely to remain volatile.
	Floating Rate Loans ▼		Loans' short duration profile is attractive in a rising rate regime, but that benefit is mostly priced in. Solid fundamentals and attractive valuations remain supportive, although liquidity and recession concerns remain.
	EM Dollar Sovereigns		Yield levels look attractive versus developed markets but reflective of rising global growth and inflation concerns. Prospects for stimulus from China are supportive.
	EM Local Currency		EM yields are at attractive levels amid central bank tightening and risk-off sentiment. However, a strong US dollar continues to be a headwind.

[1] For pairwise decisions in style & market capitalization, positioning within boxes represent positioning in the first mentioned 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 & market capitalization asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

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6 Portfolio Implementation

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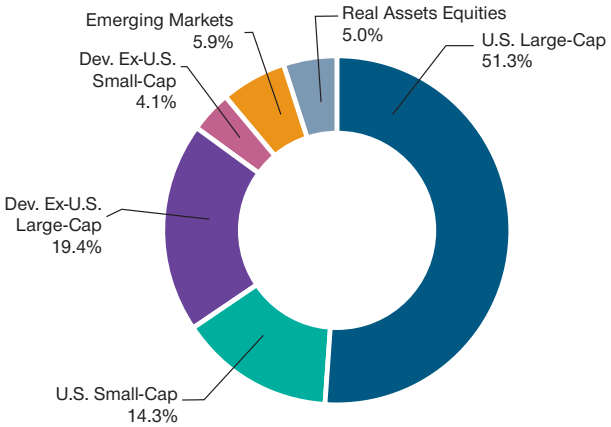
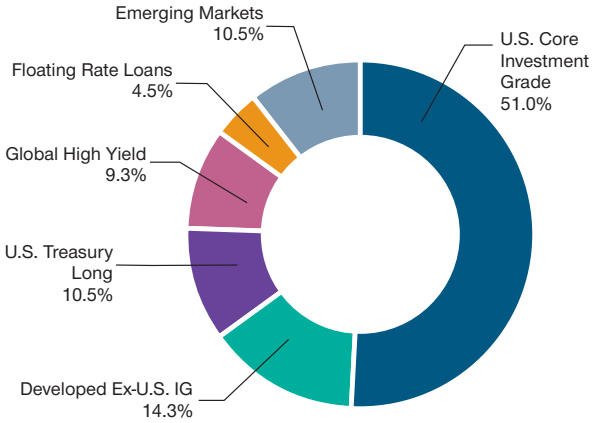
Equity	Neutral Weight	Tactical Weight	Relative Weight
U.S. Large-Cap	52.5%	51.3%	-1.2%
U.S. Small-Cap[1]	13.5	14.3	+0.8
Dev. Ex-U.S. Large-Cap	21.0	19.4	-1.6
Dev. Ex-U.S. Small-Cap	4.0	4.1	+0.1
Emerging Markets	4.0	5.9	+1.9
Real Assets Equities	5.0	5.0	0.0
Total Equity:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Fixed Income	Neutral Weight	Tactical Weight	Relative Weight
U.S. Core Investment Grade	55.0%	51.0%	-4.0%
Developed Ex-U.S. IG (Hedged)	15.0	14.3	-0.8
U.S. Treasury Long	10.0	10.5	+0.5
Global High Yield	7.0	9.3	+2.3
Floating Rate Loans	3.0	4.5	+1.5
Emerging Markets - (Local/Hard Currency)	10.0	10.5	+0.5
Total Fixed Income:	**100.0%**	**100.0%**	

Tactical Allocation Weights



[1] U.S. small-cap includes both small- and mid-cap allocations.

Source: T. Rowe Price. Unless otherwise stated, all market data are sourced from FactSet. Copyright 2022 FactSet. All Rights Reserved.

These are subject to change without further notice. Figures may not total due to rounding.

Neutral equity portfolio weights representative of a U.S.-biased portfolio with a 70% U.S. and 30% international allocation; includes allocation to real assets equities. Core fixed income allocation representative of U.S.-biased portfolio with 55% allocation to U.S. investment grade.

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