Global Asset Allocation Viewpoints

January 2023

1 Market Perspective

As of 31 December 2022

- Volatility likely to remain elevated in the new year as central bank policy expectations diverge amid evidence of slowing growth and moderating inflation.
- While slowing the pace of tightening, the U.S. Federal Reserve reinforced its commitment to taming inflation, signaling policy rates may need to stay higher for longer despite the negative impacts on growth and employment.
- The European Central Bank (ECB) struck a hawkish tone amid its battle against inflation despite acknowledging the likelihood of a near-term recession. The Bank of Japan made a surprise move toward policy normalization by adjusting its yield curve controls to provide flexibility for yields to move higher.
- Moderating pressures from higher U.S. rates and a strong U.S. dollar could become tailwinds for emerging market economies and a reprieve for their central banks. While uncertainty remains, sentiment towards China could improve following easing of zero-Covid restrictions along with signaling from policymakers that more stimulus measures are on the way.
- 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 December 2022

- We remain underweight stocks. Earnings estimates remain too optimistic, not yet reflecting the potential for weaker demand and higher input prices weighing on profit margins.
- We remain modestly overweight cash relative to bonds, reducing portfolio duration while earning attractive yields and providing liquidity should market opportunities arise.
- 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 are overweight high yield, where valuations offer reasonable compensation for risks. While fundamentals remain generally supportive, default rates are expected to rise from historically low levels towards longer-run averages. We also hold a modest overweight to long-term U.S. Treasuries as a risk-off ballast to equities and other risk assets.

3 Market Themes

As of 31 December 2022

Re-Open for Business

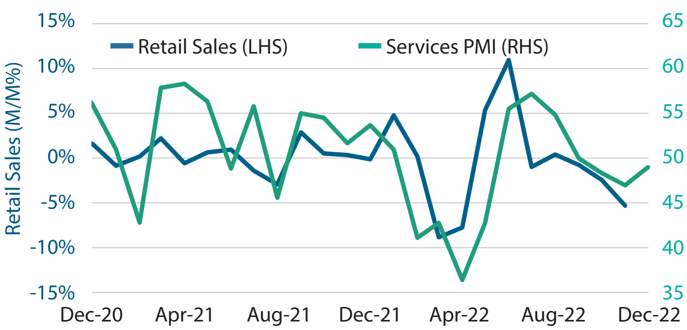
In early December, Chinese policymakers surprised markets by announcing a pivot away from strict zero-Covid policies. The measures had been effective in containing the virus through targeted lockdowns, testing, and quarantines but at high economic and social costs. The reopening announcement partially removed virus testing requirements, restrictions on domestic travel and production stoppages. The news was welcomed by those impacted and championed by the markets as the world has been awaiting China's reopening to provide a lift to global growth. Unfortunately, the reopening has been met with a wave of infections across the country resulting in the population being cautious to reengage in outside contact and travel. While China's reopening should ultimately be a positive for growth in 2023, it is likely to unfold over the balance of the year. As more of the population reengages it will provide a boost for domestic growth, fueled by pent-up demand and savings accumulated over the shutdown. Additionally, a re-emergent Chinese economy should be supportive for broader emerging markets and commodities as growth and trade rebound. As investors happily leave 2022 behind, China's success this year in reopening its economy, stabilizing growth, and addressing risk in its property sector could be positive catalysts that help turn market sentiment around.

No Quick Fix

While there has been a growing number of companies announcing layoffs and hiring freezes over recent months, notably across technology and financial services sectors, the unemployment rate remains anchored near historically low levels with millions of job openings still in the economy. Consumer demand remains strong across services sectors of the economy, including transportation and leisure. However, employers are dealing with a shortage of workers, resulting in the need to offer higher wages to attract and retain talent. On the labor supply front, Covid resulted in an increased amount of people exiting the workforce, particularly in sectors that were shut down entirely over the course of the pandemic. Workers have also been more willing to quit jobs in search of higher wages and better benefits, including flexibility to work remotely. The tightness of the labor market and rising wages has the Fed's attention, and while the decline in goods inflation amid improving supply chains has been a welcomed sign, services inflation is likely to be more of a challenge. Unfortunately for the Fed, there is no quick fix for improving the labor supply chain, leaving them more likely to keep policy tighter for longer until they see a cooling in demand for jobs.

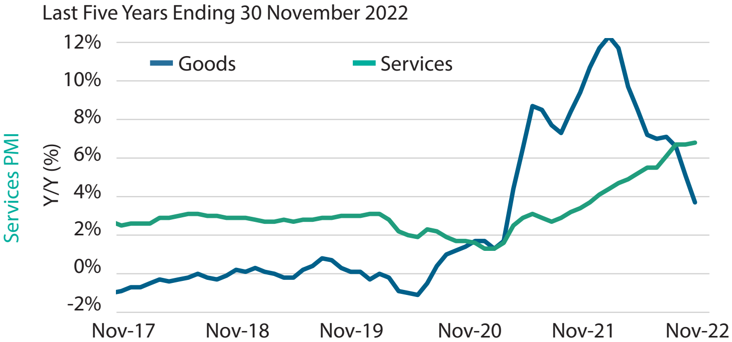
China: Awaiting Turnaround in Domestic Growth

31 December 2020 to 31 December 2022



U.S.: Goods vs. Services Inflation

Last Five Years Ending 30 November 2022



Sources: Haver Analytics/China National Bureau of Statistics, Caixin/S&P Global. Haver Analytics/Bureau of Labor Statistics. Please see Additional Disclosures for more information about this S&P Global information.

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4 Regional Backdrop

As of 31 December 2022

	Positives	Negatives
United States	▪ Strong corporate and consumer balance sheets ▪ Resilient labor market ▪ Supply chain issues improving rapidly ▪ Persistent demand for services	▪ Stubbornly high inflation ▪ Restrictive monetary policy ▪ Labor supply shortages ▪ Deteriorating corporate margins
Europe	▪ Fiscal spending likely to increase ▪ Attractive equity valuations ▪ ECB bond-buying backstop ▪ Historically warm winter has eased energy costs	▪ Recession risk is very high ▪ Industrial production will be curtailed by energy shortages ▪ ECB remains hawkish ▪ Sovereign debt risks are rising ▪ Limited long-term catalysts for earnings growth
Developed Asia/Pacific	▪ Attractive equity valuations ▪ Improving corporate governance ▪ Fiscal policy remains accommodative	▪ Global trade volumes are slowing ▪ Limited long-term catalysts for earnings growth ▪ Monetary policy no longer supportive
Emerging Markets	▪ Chinese authorities are easing monetary and credit conditions and providing housing market support ▪ Equity valuations are attractive relative to the U.S. ▪ COVID restrictions have been loosened	▪ High likelihood of near-term COVID disruptions in China ▪ Global trade volumes are slowing ▪ Chinese housing concerns have impacted industrial activity ▪ Geopolitical risks are elevated

5 Asset Allocation Committee Positioning

As of 31 December 2022

▼ 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			■				Stocks remain vulnerable amid tightening liquidity and a hawkish Fed. Earnings expectations have begun to fade but remain optimistic against a growing likelihood of recession.
ASSET CLASS	Bonds					■		The balance between central bank tightening, high inflation and deteriorating growth has kept rate volatility elevated. Credit sectors, such as high yield, offer attractive yields and fair spreads with broadly supportive fundamentals.
	Regions							
EQUITIES	U.S.			■				U.S. equities remain expensive on a relative basis. The U.S. economy appears to be on stronger footing than the rest of the world, though U.S. tech giants may prove to be more cyclically sensitive than expected.
EQUITIES	Global Ex-U.S.					■		Inflation concerns, tighter central bank policy, and an energy crisis in Europe are notable headwinds. However, valuations are attractive on a relative basis and local currencies have room to appreciate.
EQUITIES	Europe			■				Valuations are compelling, but elevated energy costs and weakening manufacturing activity have made a recession highly likely. Sovereign debt challenges are also elevated within the European periphery as the ECB continues to raise rates.
EQUITIES	Japan					■		Despite cyclical concerns, Japan offers historically cheap valuations, accommodative fiscal policy, and improving corporate governance. While a weaker Yen should benefit corporate competitiveness, the recent shift in monetary policy has helped stabilize the currency.
EQUITIES	Emerging Markets (EM)					■		Valuations and currencies are attractive. Central bank tightening may have peaked. Meanwhile, the medium-term outlook in China has improved with the relaxation of COVID restrictions and the promise of more stimulus.
	Style & Market Capitalization							
EQUITIES	U.S. Growth vs. Value[1]			■				Relative valuations for value stocks remain attractive while energy sector earnings could provide support. Growth stocks face near-term headwinds as consumer spending continues to shift away from stay-at-home businesses.
EQUITIES	Global Ex-U.S. Growth vs. Value[1]				■			Value stocks offer extremely attractive valuations. However, they could face significant pressure as cyclical risks rise due to tightening monetary policy, sovereign debt concerns, weakening auto demand, and the European energy crisis.
EQUITIES	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 reasonably well thus far despite economic headwinds. Higher-quality bias is warranted.
EQUITIES	Global Ex-U.S. Small vs. Large-Cap[1]				■			Small-caps offer idiosyncratic opportunities and attractive valuations. However, caution is warranted due to a potential flight to quality that could favor large-caps.
	Inflation-Sensitive							
EQUITIES	Real Assets Equities				■			Commodity prices may face further pressure due to global economic concerns. However, real assets offer an attractive hedge if inflation remains elevated.
BONDS	U.S. Investment Grade (IG)		■					Peaking inflation and moderating Fed policy likely lessens the risk of significantly higher yields, while corporate and securitized markets offer attractive valuations and supportive fundamentals.
BONDS	Developed Ex-U.S. IG (Hedged)			■				Developed ex-U.S. yields could remain volatile as global central banks balance elevated inflation versus slower growth. Fed moderating the pace of hiking should narrow interest rate differentials, softening U.S. dollar strength.
BONDS	U.S. Treasury Long					■		While yield volatility could persist, slowing economic growth and inflation could provide a tailwind for longer duration bonds.
BONDS	Inflation-Linked				■			Further evidence of slowing inflation could be a headwind for inflation-linked bonds. However, should inflation prove to be more resilient, the sector can offer a hedge.
BONDS	Global High Yield					■		Credit fundamentals remain supportive despite a more challenging economic backdrop. Higher yields offer attractive income and a buffer should credit spreads widen. Default rates are likely to rise from historically low levels towards longer-run averages.
BONDS	Floating Rate Loans					■		The benefits of loans' short duration profile and resetting rate feature become less compelling on moderating Fed policy and slower growth. While valuations remain attractive, liquidity in the sector requires attention.
BONDS	EM Dollar Sovereigns					■		Yield levels look attractive as EM growth prospects benefit from China moving towards reopening. Peaking central bank tightening and moderating inflation should also be supportive.
BONDS	EM Local Currency					■		EM currencies and local yields are at attractive levels, reflecting cautious sentiment. As the Fed slows the pace of interest rate tightening and U.S. dollar strength fades, EM currencies may benefit.

[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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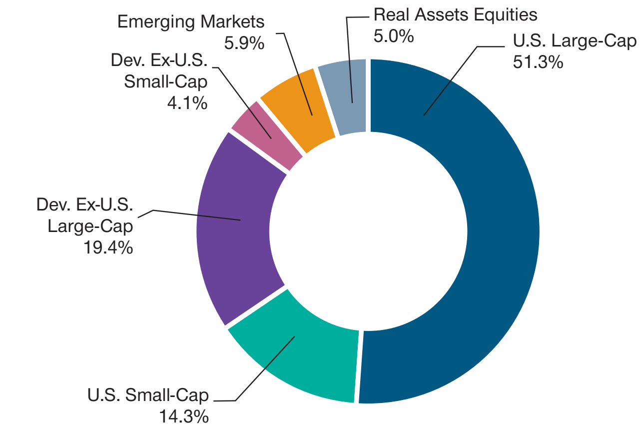
6 Portfolio Implementation

As of 31 December 2022

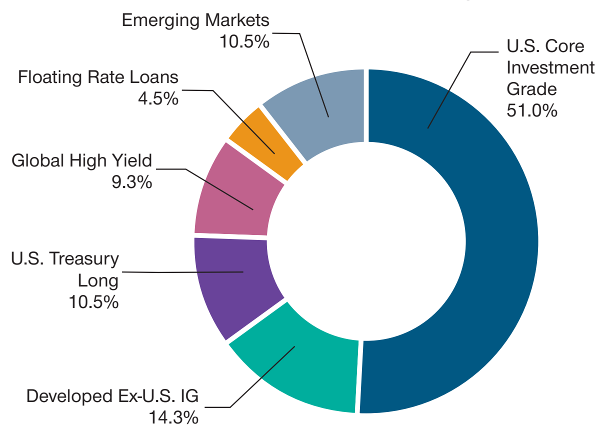
Equity	Neutral Weight	Tactical Weight	Relative Weight
U.S. Large-Cap	52.5%	51.3%	-1.2%
U.S. Small-Cap[1]	13.5	14.3	+0.8
Dev. Ex-U.S. Large-Cap	21.0	19.4	-1.6
Dev. Ex-U.S. Small-Cap	4.0	4.1	+0.1
Emerging Markets	4.0	5.9	+1.9
Real Assets Equities	5.0	5.0	0.0
Total Equity:	**100.0%**	**100.0%**	

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 2023 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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