



# GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

AUGUST 2019

## MARKET INSIGHTS

As of July 31, 2019

### The First Cut Is (Not) the Deepest

As expected, the Fed cut interest rates for the first time since 2008 to “insure against downside risks” and ended the balance sheet runoff two months early. The 25 basis point cut was less than some pundits had hoped and was widely viewed as hawkish following Powell’s suggestion that this was a “midcycle adjustment” rather than the start of an easing cycle. However, history has shown that “insurance cuts” are often the first in a series to follow. President Trump’s subsequent ratcheting up of the trade war by extending tariffs to nearly all Chinese imports could likely necessitate the need for further easing. With U.S. 10-year treasury yields falling to the lowest level since 2016 on the news, the next cut may be right around the corner.

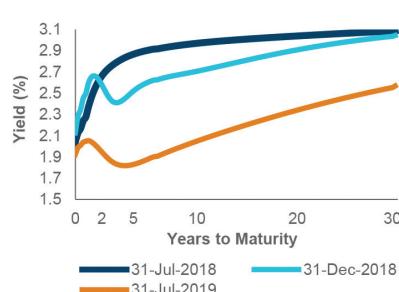
### Brexit—Will Europe Bend to Boris’s Hard Line?

On 23 July, Boris Johnson sealed the Conservative Party leadership contest and was named UK Prime Minister. Since then, Johnson has been galvanizing Brexit support and increasing pressure on negotiators with his commitment to renegotiating May’s Withdrawal Agreement, deleting the Irish backstop, and assuring exit will occur on October 31st, with or without a deal. With both sides entrenched and just three months to go, the odds of a no-deal Brexit are perilously high. The uncertainty has sent the pound to a two-year low with further downside likely should a no-deal exit occur. Johnson’s slim majority leaves him vulnerable to a no-confidence vote but, even if a general election was called, it is not clear that any single party would gain enough support to stop what is looking more like the inevitable.

### Earnings—U.S. Consumer to the Rescue (For Now)

As the 2nd quarter U.S. earnings season winds down, earnings beats have lifted results modestly into positive territory for the quarter, allaying fears of a possible earnings recession. However, slower global growth, a strong dollar, and trade disruption are taking a toll on multi-national companies, especially those with more than 50% revenue exposure outside the U.S., which have posted double-digit earnings declines this quarter. In contrast, domestically-oriented businesses are reporting mid-single digit growth supported by a resilient U.S. consumer. With the ratcheting up of tariffs on goods such as toys, apparel, and smartphones, U.S. consumer spending could retrench, and domestic-oriented companies may start feeling the pain too.

**FIG. 1: U.S. Treasury Yield Curves**



**FIG. 2: British Pound Cross Rates**



**FIG. 3: S&P 500 Earnings Growth: Q2 2019**

As of July 31, 2019



**Past performance is not a reliable indicator of future performance.**

Sources: Bloomberg Index Services Limited and Standard & Poor’s. Financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved. Please see additional disclosures on the final page.

 **Positives****Developed Europe**

- Monetary policy remains very accommodative
- Indirect beneficiary of China stimulus
- Economic growth showing signs of improvement
- Dividend yields remain strong

 **Negatives**

- Economic growth is muted
- Limited scope for ECB to stimulate further
- Geopolitical risks remain elevated (e.g., Brexit)
- Export weakness, vulnerable to trade and China growth
- Banking sector remains challenged

**United Kingdom**

- Wage growth has risen despite Brexit fears
- Inflation has remained on target
- Britain's trade deficit with the rest of the world has stabilized as companies have reduced stockpiling, although it leaves little room for complacency
- Britain's fiscal position provides flexibility for government spending to be increased should the economy weaken

- The arrival of new PM Boris Johnson has increased the chance of a no-deal Brexit, which—if it occurs—could trigger a recession
- Sterling remains very weak amid Brexit concerns
- PMI data continue to suggest slowing business activity

**United States**

- Fed easing, stable inflation
- Healthy consumer spending, strong employment, and improving wages
- Lower rates driving a rebound in housing
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of world

- Trade negotiations remain adversarial
- Slowing economic growth with fading fiscal stimulus
- Muted near-term earnings expectations
- Faltering capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and elevated margins
- Elevated corporate and government debt levels

## Positives

**Japan**

- Expectations for economy and corporate earnings have been marked down significantly given poor economic momentum, creating upside surprise risk
- Recent economic data are mixed, but some green shoots are suggesting that slowdown might find a bottom soon
- Japanese stocks have rarely been cheaper. Meanwhile, improving governance seen through buybacks and ROE, along with increasing number of start-ups, remains underappreciated

## Negatives

- Corporate earnings are highly sensitive to global economy, which is, at best, stabilizing at below-potential pace
- Despite ongoing commitment from the BoJ for ultra-loose monetary policies, there is not much room left for additional easing in case of an abrupt economic downturn
- JPY is likely to appreciate given weak valuation, uncertain risk sentiment, and lower interest rate differential with the U.S. An exchange rate below 109 versus USD raises earnings concerns.
- Trade tensions with South Korea are creating new uncertainties

**Asia ex Japan**

- Benefits from Chinese stimulus measures yet to be seen. Recent data have been mixed, but it is too early to call a bottom in growth trajectory
- Chinese monetary policy is labeled as prudent, but new proactive measures can still be expected to address stress areas for small businesses and banks
- Economy seems resilient with business and consumer confidence stabilizing and housing-related downside risks diminishing
- RBA delivered on expected rate cuts, loosening credit conditions. Fiscal stimulus will also help

- Full impact of Chinese trade tensions with U.S. yet to be seen, especially regarding capex plans, supply chains, and trade activity
- China's firm political stance versus the U.S. might create undesired consequences domestically in the medium term
- Recent buoyant price movements in Australia seem disconnected with below-potential economic growth and could reflect overly optimistic expectations for the RBA and newly elected government
- Commodity prices set to roll over as specific supply disruptions are progressively resolved

**Emerging Markets**

- Muted inflation, more dovish Fed give central banks flexibility to ease
- Beneficiary of Chinese stimulus
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle

- Export-driven economies are highly vulnerable to rising trade tensions
- Instability in several key markets (Turkey, Argentina, and Brazil) could persist
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused

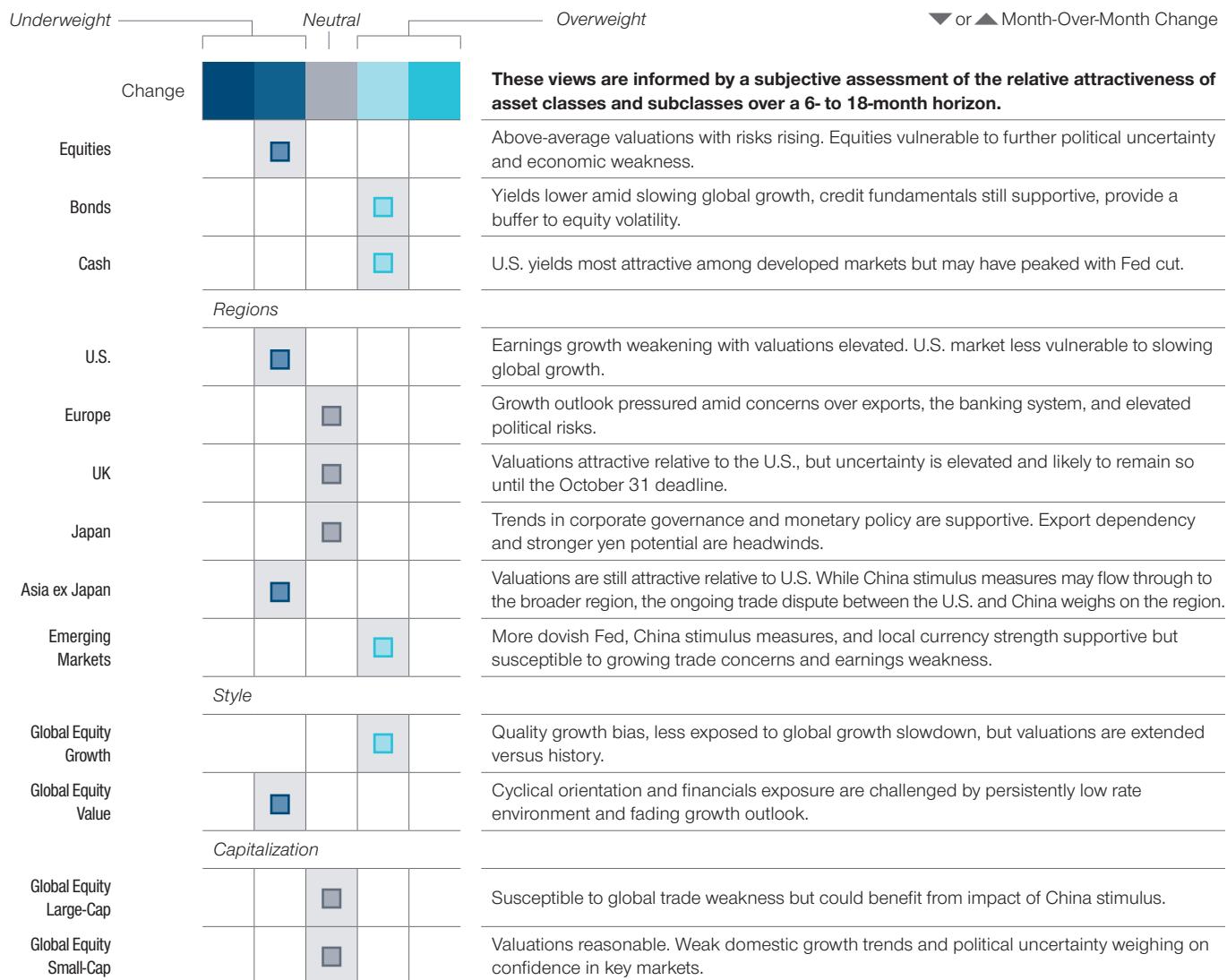


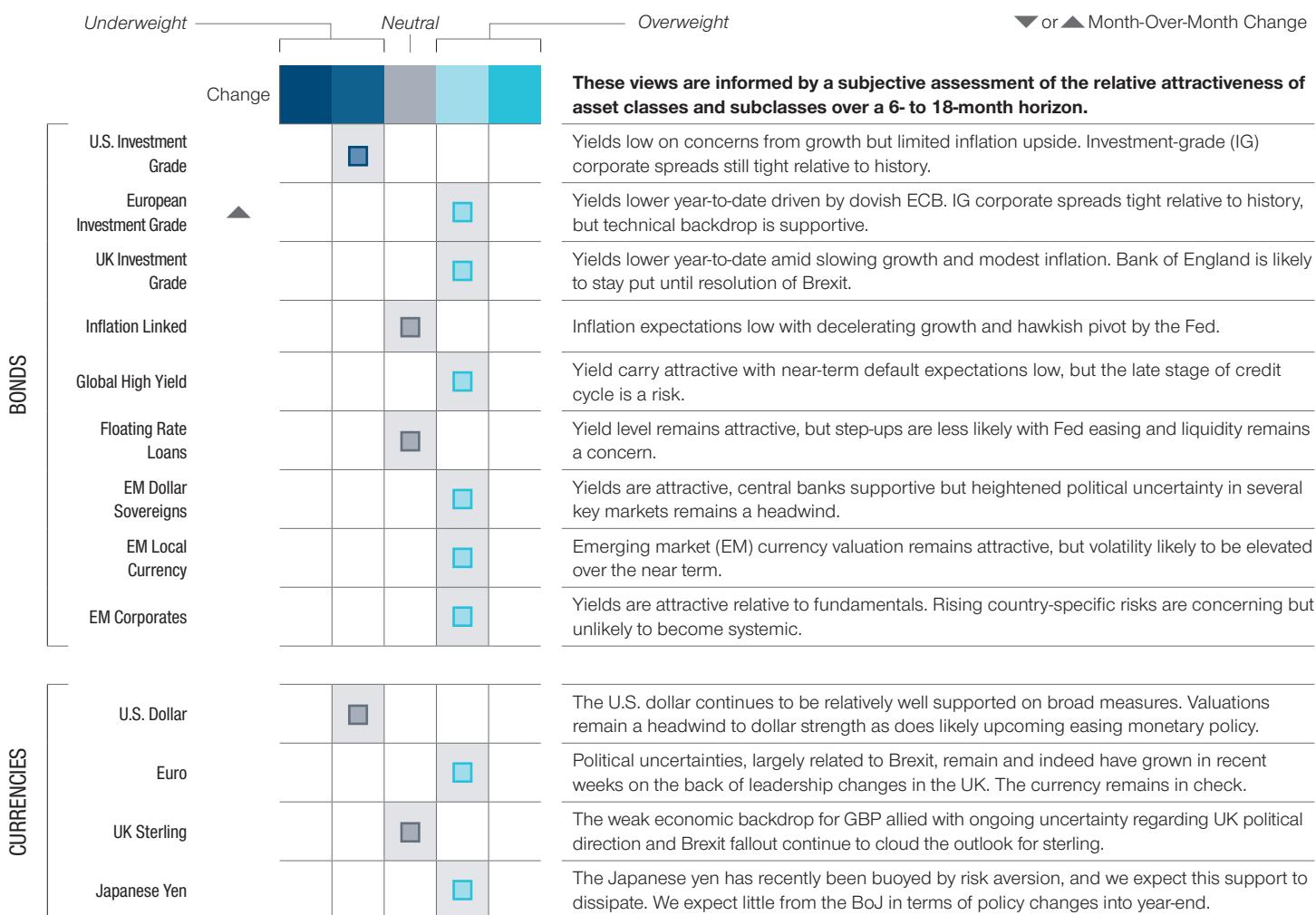
## ASSET ALLOCATION COMMITTEE POSITIONING

As of July 31, 2019

ASSET CLASSES

EQUITIES





T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

# T. Rowe Price<sup>®</sup>

## ADDITIONAL DISCLOSURES

Source: Unless otherwise stated, all market data are sourced from Factset. Financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved.

Bloomberg Index Services Limited. BLOOMBERG<sup>®</sup> is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively “Bloomberg”). BARCLAYS<sup>®</sup> is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, “Barclays”), used under license. Bloomberg or Bloomberg’s licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

The S&P 500 Index is a product of S&P Dow Jones Indices LLC, a division of S&P Global, or its affiliates (“SPDJI”), and has been licensed for use by T. Rowe Price. Standard & Poor’s<sup>®</sup> and S&P<sup>®</sup> are registered trademarks of Standard & Poor’s Financial Services LLC, a division of S&P Global (“S&P”); Dow Jones<sup>®</sup> is a registered trademark of Dow Jones Trademark Holdings LLC (“Dow Jones”). T. Rowe Price’s product is not sponsored, endorsed, sold or promoted by SPDJI, Dow Jones, S&P or their respective affiliates, and none of such parties make any representation regarding the advisability of investing in such product nor do they have any liability for any errors, omissions, or interruptions of the S&P 500 Index.

**Key Risks**—The following risks are materially relevant to the information highlighted in this material:

Even if the asset allocation is exposed to different asset classes in order to diversify the risks, a part of these assets is exposed to specific key risks.

**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.

**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.

**Small and mid-cap risk**—stocks of small and mid-size companies can be more volatile than stocks of larger companies.

**Style risk**—different investment styles typically go in and out of favor depending on market conditions and investor sentiment.

## Important Information

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources’ accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

**DIFC**—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

**EEA ex-UK**—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

**UK**—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

**South Africa**—T. Rowe Price International Ltd (“TRPI”) is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide “intermediary services” to South African investors.

**Switzerland**—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

© 2019 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.