



# Changes the Asset Allocation Committee Has Made

Amid the volatility, we remain disciplined in our process.

March 2020

## KEY INSIGHTS

- As the coronavirus disrupts lives and trade worldwide, coordinated monetary and fiscal policies are essential to mitigate the stresses to global economies.
- Recession is likely in several developed European and Asian countries by mid-2020, and the probability is increasing that the U.S. economy will contract.
- We have been incrementally adding to equities as valuations are beginning to price in a substantial decline in economic growth and corporate earnings.

**T. Rowe Price**  
*Asset Allocation Committee*

## Q. What is your view on the current environment?

We believe that global policymakers are now more coordinated in their responses to stem the impacts of the coronavirus on the global economy. The U.S. Federal Reserve and other major central banks have sharply lowered interest rates while pledging a return to aggressive quantitative easing measures. The U.S. and several other countries are also implementing fiscal stimulus measures to support their economies. In our view, the aggressive measures taken by policymakers are important in providing stability and liquidity to the volatile markets.

How the coronavirus outbreak will ultimately impact economic growth and corporate earnings will largely be driven by the duration of the crisis. In the short term, it is likely that several developed market economies in Europe and Asia will dip into recession in the first half

of 2020, and the U.S. could likely see contraction in the coming quarters.

## Q. What actions are you taking in this environment?

### Disciplined Rebalancing

As risk assets have sold off aggressively, more defensive assets, such as U.S. Treasury bonds, have become increasingly expensive. In this environment, we continue to focus on rebalancing our portfolios with discipline. Our exposure to core investment-grade bonds and U.S. long-term Treasuries, which have performed strongly, has provided a natural funding source for rebalancing into equities, which have declined.

### Measured Additions

While it is difficult to call a bottom to the current sell-off in risk assets, we are confident that markets will normalize once the impacts of the coronavirus pass. Given our long-term investment

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horizon, we are adding incrementally to average into positions where we find attractive valuations.

We have selectively added across equities as valuations are beginning to price in a substantial contraction in economic growth and a decline in corporate earnings. We have funded the additions from core investment-grade bonds that have become increasingly expensive and riskier as their durations<sup>1</sup> have extended.

Within U.S. equities, although we remain overweight to growth stocks, we have moderated our underweight to value stocks, which have significantly lagged growth stocks amid the sell-off. While value-oriented equities are more cyclical, their relative valuations versus growth stocks have reached extreme levels and could be poised for a more pronounced rebound once volatility mitigates.

**Q. What key market indicators are you watching?**

We are actively monitoring the crisis at a macro level as well as its impacts on market liquidity and the risks to corporate credit and fundamentals. While the market sell-off is not the result of a financial crisis, an extended period of uncertainty could exacerbate financial and liquidity stresses. However, we believe that—given their aggressive action—central banks are committed to mitigating these stresses.

We are also focused on how countries across the globe are responding to contain the spread of the virus. While monetary and fiscal measures may support the potential economic impacts in the weeks and months ahead, investors are keenly focused to see evidence that the spread of the coronavirus is moving past its peak. Data suggesting a slowdown in

new infections will be a key catalyst in stabilizing markets.

**Q. How were you prepared going into the current sell-off?**

Our multi-asset investment approach emphasizes broad diversification, the importance of active management, a long-term horizon, and an understanding of the risks at each level of the portfolio.

**Diversification:** While the pronounced sell-off in risk assets has been broad-based, the drawdown<sup>2</sup> to our diversified multi-asset funds has been buffered by allocations to core bonds, as yields have reached record-low levels amid the flight to quality assets. Notably, the strategic allocations to long-term U.S. Treasury bonds as a ballast to equities has been a significant contributor to returns in the current environment, helping to offset equity market drawdowns and provide liquidity.

**Active Management:** As the crisis unfolds, it is ever more important for us to understand the impacts at not only the asset class level, but also at the individual company level as well. Our global research capabilities give us a deep understanding of each portfolio holding.

Indiscriminate and broad-based market sell-offs can provide opportunity for active investors to benefit by buying quality companies at distressed valuations. Our ability to rebalance our portfolios from expensive core bonds into stocks—that have cheapened significantly—gives us capital to deploy where we are finding quality companies at deeply discounted prices.

**Long-Term Horizon:** Our tactical asset allocation approach looks out over a 6- to 18-month time horizon, with an emphasis on relative valuations. Our longer investment horizon provides us with the patience and flexibility to

<sup>1</sup> Duration measures a bond's sensitivity to changes in interest rates.

<sup>2</sup> A decline in performance of an investment or fund.

average into positions when markets sell off aggressively. We believe that as the impacts of the coronavirus ultimately begin to abate, volatility will subside, and markets will refocus on fundamentals.

**Risk-Aware Approach:** We emphasize risk management at each level of our multi-asset investment process. Our portfolios are designed with an emphasis

on understanding the potential risks versus returns; as such, we seek to build portfolios that can weather a range of market environments. Our goal is to achieve this by including diversifying elements that have lower correlations<sup>3</sup> with each other and can mitigate overall portfolio risk.

<sup>3</sup> Correlation measures how one asset class, style or individual group may be related to another.

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