



GLOBAL ASSET ALLOCATION: THE VIEW FROM EMEA

SEPTEMBER 2019

MARKET INSIGHTS

As of August 31, 2019

Brexit: Mess Gets Messier

With only weeks left until the October 31 deadline, UK Prime Minister Boris Johnson moved to suspend Parliament to thwart opposition lawmakers' chances of blocking a no-deal Brexit, causing both consumer and business confidence to tumble. Johnson's gamble was designed to put pressure on the EU but instead pitted himself against Parliament, which moved swiftly to block his proposed no-deal Brexit. While the probability of a near-term disorderly exit has significantly decreased, neither side seems to have a plan to resolve the key sticking points with Brussels. In the meantime, the move promises further economic uncertainty with another delay and an election likely this year.



Yoram Lustig
Head of Multi-Asset Solutions, EMEA

Mind the (Trade) Gap

Risk assets have had a turbulent August amid renewed anxieties surrounding trade, with the U.S. announcing new tariffs and Chinese authorities allowing the yuan to weaken against the dollar while halting U.S. agricultural purchases. However, markets rallied into month-end as trade rhetoric abated on both sides despite additional tariffs on key consumer goods, such as electronics and footwear, which are due to go into effect on September 1. While a resumption of dialogue provides hope, the gap that has formed between the two sides from retaliatory tariffs has made the possibility of a near-term substantive deal even more remote. Meanwhile, trade continues to weigh on growth, and the lingering uncertainty is already impacting capital decisions.

Shop Till the Economy Drops

Amid continued manufacturing weakness and a slowing economy, the U.S. consumer appears unfazed as spending (which accounts for more than two-thirds of U.S. economic activity) grew at its fastest rate since 2014. The consumer has benefited from solid wages, a tight labor market, low interest rates, and low inflation as existing tariffs have been largely absorbed by companies to date. However, with the most recently announced tariffs that are expected to take effect in September and December being largely consumer goods focused, the consumer may no longer be immune to the trade war. If companies pass the tariff impacts on to the consumer and demand suffers, recession odds could sharply tick upward.

FIG. 1: British Pound Cross Rates
Five Years Ended August 31, 2019

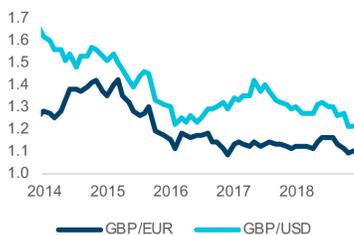


FIG. 2: Inflation: Tariffed vs. Non-tariffed Goods
December 31, 2015, Through July 31, 2019

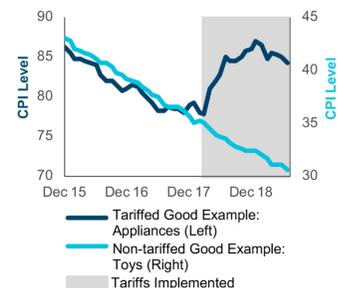
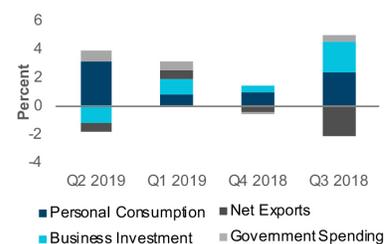


FIG. 3: U.S. GDP Breakdown



Past performance is not a reliable indicator of future performance.

Sources: Bloomberg Finance L.P., financial data and analytics provider FactSet. Copyright 2019 FactSet. All Rights Reserved. Please see additional disclosures on the final page.

FOR INVESTMENT PROFESSIONALS ONLY. NOT FOR FURTHER DISTRIBUTION.



 **Positives**

 **Negatives**

- Developed Europe**
- Monetary policy increasingly accommodative
 - Indirect beneficiary of China stimulus
 - Dividend yields remain strong

- Economic growth remains under pressure
- Geopolitical risks remain elevated (e.g., Brexit)
- Export weakness, vulnerable to trade and China growth
- Limited scope for European Central Bank (ECB) to stimulate further
- 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 this 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 Prime Minister 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
- Purchasing managers' index 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** **Negatives**

-
- Japan**
- Expectations for economy and corporate earnings have been marked down significantly given poor economic momentum, creating upside surprise risk
 - Public investment and domestic consumption should still be positive contributors to economic activity
 - Japanese stocks have rarely been cheaper. Meanwhile, improving governance seen through buybacks and return on equity, along with increasing number of start-ups, remains underappreciated
- Corporate earnings are highly sensitive to global economy, which is, at best, stabilizing at below-potential pace
 - Despite ongoing commitment from the Bank of Japan (BoJ) for ultra-loose monetary policies, there is not much room left for additional easing in case of abrupt economic downturn
 - Japanese yen (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 U.S. dollar (USD) raises earnings concerns

-
- 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
 - Latest reform on Chinese loan prime rate should improve transmission of monetary policy. Expect some easing but not as significant as in 2015 and during global financial crisis
 - The Australian economy seems resilient, with business and consumer confidence stabilizing and housing-related downside risks diminishing
 - The Reserve Bank of Australia (RBA) can continue easing cycle given low inflation and global monetary easing trend. Fiscal stimulus should also help
- Full impact of Chinese trade tensions with U.S. yet to be seen, especially regarding capex plans, supply chains, and trade activity. Companies have expressed concerns, while negative impacts from current frontloading expected to be felt later this year
 - China's firm political stance versus the U.S. might create undesired consequences domestically in the medium term
 - Optimistic expectations already priced in for the RBA and newly elected government
 - Year-to-date gains in local equity markets have exceeded peers, limiting further upside. Meanwhile, earnings outlook is stable and unlikely to provide a positive catalyst

-
- 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
 - Gross domestic product (GDP) forecasts for emerging market (EM) economies continue to decline
 - Instability in several key markets (Turkey, Argentina) could persist
 - Slowing long-term China growth trajectory remains a headwind
 - China stimulus more measured and domestically focused





		Positioning					▼ or ▲ Month-Over-Month Change
		Underweight	Neutral		Overweight		
		Change					
BONDS	U.S. Investment Grade		■				Yields low on concerns from growth but limited inflation upside. Investment-grade (IG) corporate spreads still tight relative to history.
	European Investment Grade				■		Yields at all-time lows owing to the rising prospect of a deflationary global economic downturn and a dovish ECB. IG corporate spreads trade tight relative to history.
	UK Investment Grade	▼		■			Yields touching all-time lows amid weakening growth and modest inflation. Bank of England is likely to stay put until resolution of Brexit.
	Inflation Linked			■			Inflation expectations low with decelerating growth and hawkish pivot by the Fed.
	Global High Yield				■		Yield carry attractive with near-term default expectations low but late stage of credit cycle a risk.
	Floating Rate Loans			■			Yield level remains attractive but step-ups less likely with Fed easing, and liquidity remains a concern.
	EM Dollar Sovereigns				■		Yields are attractive, central banks supportive, but heightened political uncertainty in several key markets remains a headwind.
	EM Local Currency				■		Emerging market currency valuation remains attractive, but volatility likely to be elevated over the near term.
	EM Corporates				■		Yields are attractive relative to fundamentals. Rising country-specific risks are concerning but unlikely to become systemic.
CURRENCIES	U.S. Dollar		■				The USD continues to be relatively well supported on broad measures. Valuations remain a headwind to dollar strength, as does likely upcoming easier monetary policy.
	Euro				■		Political uncertainties and global trade concerns have grown in recent weeks. Weak economic indicators also continue to weigh on the currency.
	UK Sterling			■			The recent trends for GBP, a weak economic backdrop, and ongoing uncertainty regarding Brexit fallout have further pressured sterling of late. It has continued to underperform.
	Japanese Yen				■		The JPY has recently been buoyed by risk aversion, and we expect this support to dissipate. We expect little from the BoJ in terms of policy changes into year-end.

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

T.RowePrice[®]

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[®] is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively “Bloomberg”). BARCLAYS[®] 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.

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 (“TRPIL”) 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.