



ASSET ALLOCATION INSIGHTS

Seeking Upside Potential

July 2020

KEY INSIGHTS

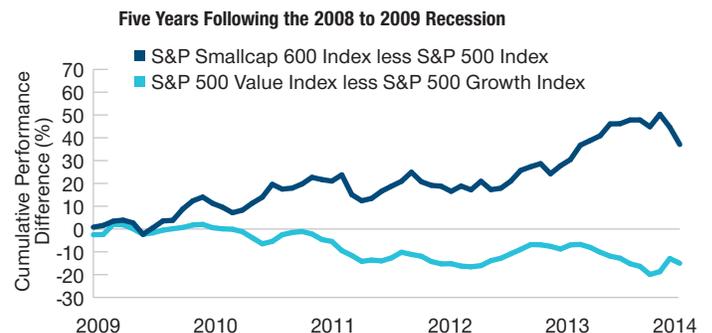
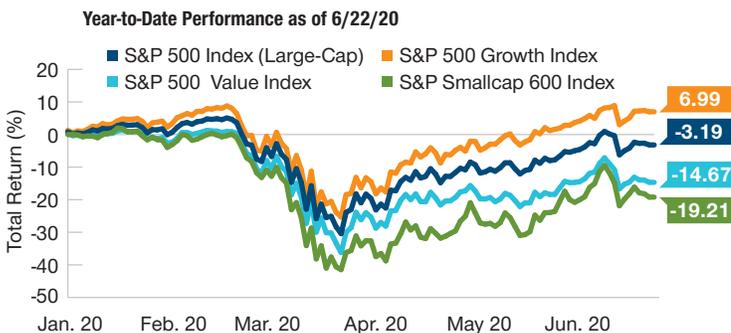
- Given the disconnect between the stock market rally and the deep economic impacts of the coronavirus pandemic, we have reduced our allocation to equities.
- We are seeking upside potential in small-cap stocks, while limiting exposure to value stocks.

The stock market rally has moderated recently, but we believe a large disconnect remains between the rebound and the deep economic impacts of the coronavirus pandemic. Given the uncertain upside potential for stocks, we reduced the allocation to equities in our multi-asset portfolios from an overweight to neutral.

Year-to-date performance among U.S. equities has varied widely. Large-cap and growth stocks have, for the most part, regained their losses. However, small-cap and value stocks, which are more vulnerable to economic weakness and typically have more debt, have lagged—resulting in attractive valuations with embedded upside opportunity but greater risk.

Uncovering Opportunities

A closer look at equity performance



Past performance is not a reliable indicator of future performance.

Sources: Standard & Poor's (see Additional Disclosures). T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Haver Analytics/Standard & Poor's.



Tim Murray, CFA
Capital Markets Strategist,
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We have chosen to overweight small-caps but not value stocks primarily because we prefer cyclical risk over secular risk. A full recovery may take a while, but we believe that cyclical forces could benefit small-caps as the economic environment improves. Conversely, secular forces that have driven equity returns over the past decade, especially within technology, have become more pronounced, and the low interest rates that have plagued financials stocks are likely to persist. These factors present significant challenges for value stocks.

For a historical perspective, after the global financial crisis—when stocks in the financials sector were weighed down by both low rates and increased regulation while technology stocks benefited from the initial stages of online adoption—small-caps outperformed, benefiting from their balanced sector exposure. However, value stocks did not.

Therefore, as the U.S. economy rebounds from recession, we believe that small-cap equities may offer a better opportunity for upside potential than value stocks.

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Style Risk—Different investment styles typically go in and out of favour depending on market conditions and investor sentiment.

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