T. Rowe Price®
INVEST WITH CONFIDENCE

Global Asset Allocation: The View From Europe

September 2021

1 Market Perspective

As of 31 August 2021

- Global economic growth remains above trend, albeit past peak levels, supported by central bank liquidity, progress on vaccine distribution and continued reopening momentum despite the spread of the delta variant.
- Policy accommodation is expected to gradually tighten as central banks weigh economic growth outlook and increased coronavirus risk against more persistent inflation and improving labour markets.
- Long-term interest rates could trend higher amid the growth and inflation outlook, but upside may be limited as growth moderates and imbalances driving inflation ease while short-term rates could begin to price in tighter central bank policy, leading to flatter yield curves.
- Key risks to global markets include the path forward for the coronavirus, elevated inflation, central bank missteps, higher taxes, a stricter regulatory environment and increasing geopolitical concerns.

2 Portfolio Positioning

- We remain modestly underweight equities relative to bonds and cash as the valuations look less compelling amid peaking growth and stimulus. Higher rates, elevated inflation and potential tax increases could pose challenges to equities.
- Within equities, we continue to favour value-oriented equities globally, US small-caps and emerging market stocks as we expect cyclically exposed companies to continue to benefit from still supportive but slowing economic growth and continued global reopening.
- Within fixed income, we continue to have a bias toward shorter-duration and higher-yielding sectors through overweights to high yield bonds and selected emerging market debt given a constructive credit outlook.

3 Market Themes

Rock and a Hard Place

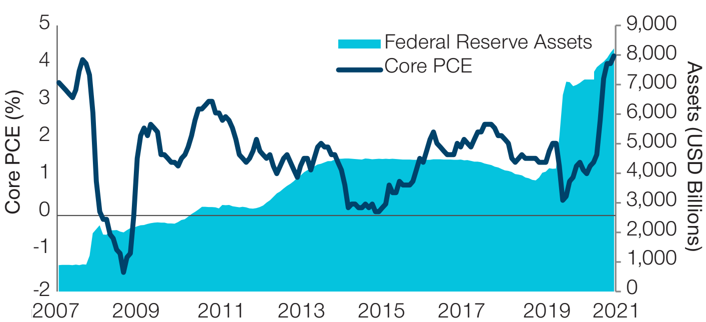
Coming out of the Jackson Hole Economic Symposium, Federal Reserve Chairman Jerome Powell signalled that the Fed could begin to wind down its monthly bond buying by year-end, if the economy and coronavirus cooperate, and acknowledged that the Fed is in no hurry to raise short-term interest rates. The equity market interpreted Powell's comments as very dovish, with the S&P 500 rallying to record-high levels on hopes that monetary policy will remain loose for longer. Powell also addressed concerns about inflation, calling it hot but temporary, attributing it to coronavirus-related supply disruptions. Recent softer-than-expected payroll data could also weigh against tightening as the Fed waits for more substantial progress towards employment goals. A scenario of moderating growth, waning employment and lingering inflation could put the Fed between a rock and a hard place—with tapering too quickly potentially jeopardising the nascent job market and complacency on inflation possibly forcing them to act more decisively down the road.

Cash Hoard

Coronavirus-related shutdowns curtailed spending by both consumers and corporations alike as expenditures on services fell significantly and corporations cut spending and dividends. Consumers working in lower-earning service sectors were the hardest hit with job losses, although they found support from fiscal aid. Higher earners, for the most part, were marginally impacted as they maintained their jobs and were able to save from less spending on services, travel and commuting. Now businesses and consumers are both seeing elevated levels of liquidity, as S&P 500 companies hold a record USD 2 trillion in cash and as household worth remains at an all-time high. Unleashed pent-up consumer demand remains as back-to-school shopping and the holiday season kicks off while, at the same time, corporations are looking to increase dividends and share buybacks. The potential for this cash hoard to come off the sidelines could provide a strong tailwind for cyclically exposed companies against a backdrop of fading fiscal and monetary support.

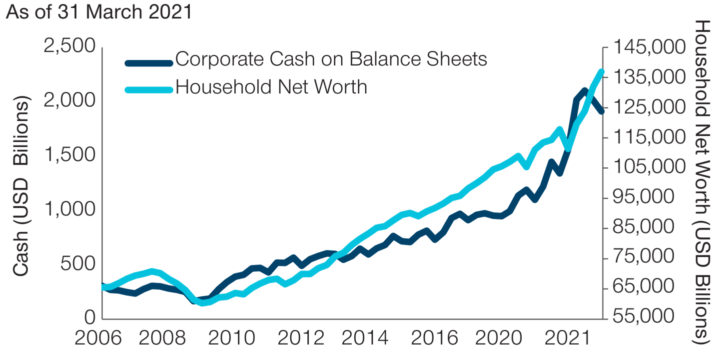
Inflation vs. Federal Reserve Assets

As of 31 July 2021



Corporate Cash and Household Net Worth[1]

As of 31 March 2021



Past performance is not a reliable indicator of future performance.

[1] Corporate Cash and Household Net Worth returns are represented by the FOF Balance Sheet of Nonfinancial Corporate Checkable Deposits & Currency Asset Index and the FOF Federal Reserve US Households & NPO Net Worth Nominal $ Value Index respectively. Figures are shown in USD.
Source: Bloomberg Finance L.P.

	Positives	Negatives
Europe	▪ Higher exposure to more cyclically oriented sectors that should benefit from economic recovery ▪ Vaccination rates improving rapidly ▪ Monetary policy remains accommodative ▪ Fiscal stimulus poised to get a boost from upcoming German elections ▪ Equity valuations remain attractive relative to the US	▪ Limited long-term catalysts for growth ▪ Limited scope for European Central Bank to stimulate further ▪ Brexit likely to negatively impact trade ▪ Demand from China fading ▪ Microchip shortage impacting auto production rebound
United Kingdom	▪ Return to offices and schools implies further rise in near-term activity ▪ Investment tax super-deduction could support strong recovery ▪ Many key economic indicators are either at or close to record highs	▪ The Bank of England could remain very hawkish in light of strong real economy data ▪ Demand risks from delayed, but likely large, fiscal consolidation in two to three years remain ▪ Overheating housing market could pose future financial stability risk ▪ Unwinding of furlough scheme could lead to a short-term rise in unemployment ▪ Scottish experience suggests a further COVID-19 wave could be on the horizon
United States	▪ Vaccinations widely distributed ▪ Infrastructure spending bill likely to be passed ▪ Healthy consumer balance sheets and high savings rate ▪ Exceptionally strong earnings growth	▪ Elevated stock and bond valuations ▪ Elevated corporate and government debt levels ▪ Fed accommodation has peaked ▪ Fiscal stimulus has peaked ▪ Corporate taxes likely to rise ▪ Delta variant spread is muting economic reopening

	Positives	Negatives
Japan	▪ Local stock markets look attractive due to favourable relative valuation, light positioning and the possibility of a politically induced stimulus ▪ Earnings are strong and being revised higher ▪ Policy setting remains extremely accommodative, with unspent fiscal spending expected to offer further boost to the economic recovery ▪ Prime Minister Suga's resignation was a surprise but it may lead to a positive stimulus package	▪ The normalisation of economic activities has been delayed due to prolonged states of emergency ▪ Favourable base effects from last year are rolling over ▪ Stagnant productivity remains a structural issue for margins in the face of a tight labour market ▪ Suga's resignation adds some uncertainty
Asia Pacific ex-Japan	▪ The slowdown in Chinese economic activity suggests further easing may come ▪ The Reserve Bank of Australia is likely to remain dovish and supportive for longer as economic data soften ▪ Australian dollar is likely to rebound given low expectations and positioning after the fall in commodity prices	▪ Chinese consumer spending is still lagging the recovery and below expectations, with consumers acting cautiously in the face of localised coronavirus outbreaks ▪ Credit risk is increasing in the Chinese property sector ▪ The impact of current lockdowns on the Australian economy and earnings seem to be underestimated
Emerging Markets	▪ Exposure to cyclical areas of economy should benefit from broad global recovery ▪ Commodity prices are elevated ▪ Equity valuations attractive relative to developed markets	▪ Vaccine supply and distribution infrastructure are well behind developed markets (excluding China) ▪ Stimulus from China is fading ▪ Accommodation from central banks is fading ▪ Limited ability to enact fiscal stimulus (excluding China) ▪ New variants remain a threat to economic activity

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Underweight — *Neutral* — *Overweight* ▼ 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		Neutral		Overweight	
ASSET CLASSES							
	Equities		■				Exceptional earnings growth and upward revisions have driven strong performance. However, valuations are elevated amid peaking growth and stimulus. Additional concerns include coronavirus challenges, input cost inflation, tax increases and higher rates.
	Fixed Income				■		Yields should be biased higher on the back of growth and inflation trending at above pre-pandemic levels, as well as tightening global central bank policies. Credit sectors offer solid fundamentals and opportunities for carry.
EQUITIES	*Region*						
	US		■				Elevated valuations reflect a strong recovery, earnings strength and low interest rates. Slowing growth, delta variant challenges, Fed tightening and higher taxes could be headwinds. Cyclical sectors should continue to benefit from a supportive macro backdrop, but a lot of good news is already priced in.
	Europe ex-UK		■				Cyclical orientation, low valuations among financials, auto production rebound and improving vaccination rate supportive. Fading Chinese growth, low rate environment and continued coronavirus challenges could dampen the rebound.
	UK				■		Continued vaccination pace is likely to lead to easing lockdown and strong real activity.
	Japan				■		Accelerating vaccine rollout, attractive valuations and strong global trade outlook should be supportive. Improving corporate governance also provides a long-term tailwind.
	Developed Asia ex-Japan*			■			Valuations attractive relative to the US. Chinese stimulus and successful containment of virus are supportive. Export- and commodity-driven economies face challenges.
	Emerging Markets (EM)				■		Valuations very attractive, and Chinese regulatory pressures may have peaked. Strength in global trade, appreciating currencies and a dovish Fed offer further support. Inflation and vaccine and delta variant challenges remain concerns.
	Style and Market Capitalisation						
	Global Growth vs. Value[1]		■				Deep cyclical orientation of value stocks combined with attractive relative valuations and improving earnings outlook could be catalysts. Vaccine progress, a rebound in manufacturing and easing of supply bottlenecks could also provide a boost.
	Global Small-Cap vs. Large-Cap[1]				■		Strong domestic growth trends remain supportive for small-caps, and idiosyncratic opportunities are plentiful. Meanwhile, the strong global economic outlook should benefit large-caps given cyclical orientation and exposure to international trade.

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*Includes Australia.

[1] For pairwise decisions in style and market capitalisation, positioning within boxes represents positioning in the first-mentioned asset class relative to the second asset class.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 August 2021

Underweight — *Neutral* — *Overweight*   ▼ 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.

	Asset	Change	Underweight	Underweight	Neutral	Overweight	Overweight	
FIXED INCOME	Euro Government Bonds		■					Europe is turning the coronavirus corner. Manufacturing purchasing managers' indexes are at record highs, and services activity is likely to pick up as European countries gradually open up.
	Euro Inflation Linked					■		While inflation expectations are on the rise, actual inflation can surprise on the upside.
	Euro Investment-Grade (IG) Corporates					■		Technicals remain supportive, but there are still plenty of uncertainties around corporate fundamentals during the recovery. Little value at current spreads, though European Central Bank buying remains supportive.
	US IG Aggregate			■				Scope for rates in Europe to rise more than in the US. However, stronger inflation and economic growth are expected in the latter.
	Global High Yield					■		Limited upside given elevated valuations; relative yields still attractive versus alternatives within fixed income. Fundamentals broadly supported by positive macroeconomic backdrop.
	EM Dollar Sovereigns				■			Attractive yield versus developed markets with improving growth broadly supportive; however, vulnerabilities across countries vary in coronavirus spread/vaccine accessibility, rising inflation and susceptibility to rising rates.
	EM Local Currency					■		Valuations remain modestly attractive; improving macroeconomic backdrop and potentially weaker US dollar could provide tailwinds. Shift higher in US rates and EM central bank rate hikes could be headwinds.
	EM Corporates					■		The impact of the pandemic on the asset class is difficult to quantify, but the prospect of normalisation bodes well. Country-specific risks remain elevated.
CURRENCIES	EUR vs. USD					■		Recent dollar weakening should continue as the US policy stance is very loose and the European reopening accelerates. Europe is also a major beneficiary of the current global manufacturing boom.
	EUR vs. JPY			■				The yen remains a safe-haven currency.

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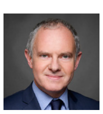
EUROPEAN INVESTMENT COMMITTEE



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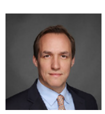

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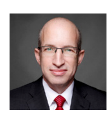

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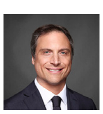

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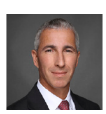

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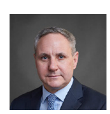

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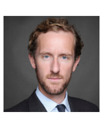

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