Global Asset Allocation: The View From Europe

June 2024

1 Market Perspective

- Global growth outlook remains positive against a backdrop of gradually easing inflationary pressures across most economies.
- While resilient, recent evidence suggests some cooling in US growth. European growth is stabilising, helped by services, with manufacturing still a laggard. Japanese growth remains stagnant, while Chinese growth shows signs of improvement supported by recent stimulus measures.
- US Fed rate cuts look to be still in play later this year, with recent signs of moderating growth and inflation. The European Central Bank (ECB) has taken the lead on cuts amongst major central banks, reducing its deposit rate by 25 basis points to 3.75% as expected, but stopping short of indicating that more cuts could follow. After hiking in March, the Bank of Japan (BoJ) is still expected to take additional steps towards tightening. The Bank of England (BoE) is expected to keep rates where they are for a while longer.
- Key risks to global markets include a steeper decline in growth, stubborn inflation, central bank policy divergence, election calendar, geopolitical tensions and trajectory of Chinese growth.

2 Portfolio Positioning

As of 31 May 2024

- We remain modestly overweight equities, supported by a still resilient economic backdrop, positive earnings trends and reasonable valuations beyond heavily concentrated areas of the market.
- We moved to an overweight to cash relative to bonds. Cash provides liquidity and attractive yields with further ECB rate cuts expected to be data dependent and gradual.
- Within equities, we are overweight US, with a preference to US large cap value that can benefit from more attractive valuations and potential for cyclical tailwinds. While we remain underweight Europe, we reduced the underweight. Valuations are relatively attractive but economic activity seems to have bottomed. A further catalyst may be needed to boost relative performance. We remain overweight Japan and neutral the UK and emerging markets (EM).
- Within fixed income, we continue to favour higher-yielding sectors, including global high yield and EM bonds, as fundamentals remain broadly supportive. However, we trimmed the overweights to these areas in favour of cash because of tight credit spreads and to reduce overall portfolio risk.

3 Market Themes

Home Improvement

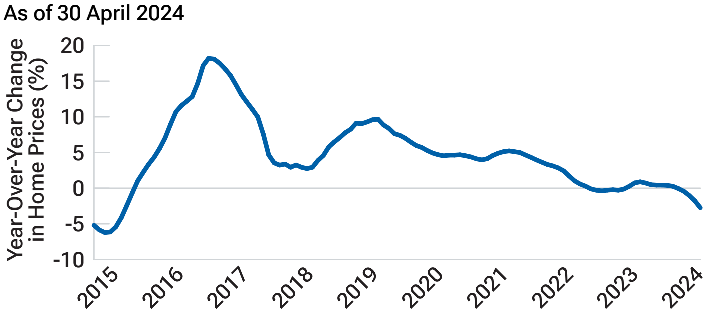
In their latest measures to stabilise the economy, Chinese policymakers took further steps targeted at improving sentiment within the country's challenged housing sector. These measures included reducing downpayment requirements, lowering the floor on mortgage rates and providing low-cost funding to help state-owned enterprises buy unsold homes. Hopes are for these measures to restore some confidence in the housing market, which has continued to see price declines amid outsized supply. On a positive note, economic growth did surprise to the upside in the first quarter, expanding by 5.3%. However, much of the growth was driven by exports and infrastructure spending, while hopes for a rebound in consumption and business spending continue to be held back by housing market woes. While recent measures to expand the Chinese economy into higher value-add sectors, including electric vehicles and semiconductors, will help diversify their economy in the long run, the property sector will likely need a much larger renovation before it turns around.

Big Spenders

While the Fed's battle with inflation has been the leading driver in the direction of yields, the move higher over recent weeks was attributed to weaker Treasury auction demand as buyers became wary of even more supply ahead. With the US election looming in the back half of the year, few are expecting either political party to significantly reduce spending or address US debt, now above 120% of gross domestic product (GDP). The unbridled spending has been flagged by the ratings agencies and is causing investors, particularly foreign investors, to demand higher yields to compensate for the risk of more supply. While some argue the big spending in Washington is growth supportive and nothing to worry about, its spillover effects on the private sector can crowd out demand and raise everyone's cost of borrowing. So for those hoping for lower rates ahead as the Fed finally reins in inflation, it could be the Washington big spenders that end up keeping rates higher for much longer.

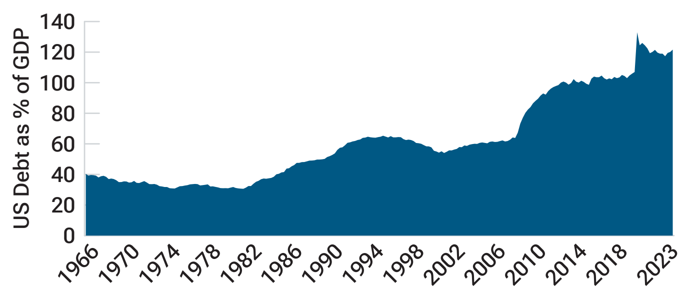
Hoping to Build Back Confidence in China's Housing Market[1]

As of 30 April 2024



Spend Now, Pay Later?[2]

As of 1 October 2023



[1] Source: Bloomberg Finance L.P. Chart represents year-over-year changes in commercial residential property prices, based on the average of the price change in each city in the National Bureau of Statistics 70 City Index.
[2] Source: St. Louis Fed. Most recent data available.

REGIONAL BACKDROP

		Positives	Negatives
Europe	U	– Monetary policy is expected to ease further – Inflation has been steadily declining – Economic sentiment is improving	– Economic growth remains weak – Geopolitical uncertainty is heightened – Earnings growth remains weak, with minimal tailwinds from innovative technologies
United Kingdom	N	– Monetary policy expected to ease – Inflation has been steadily declining – Labour market has been resilient	– Fiscal consolidation may need to be accelerated – Tight labour markets could keep wage inflation stubbornly high
United States	O	– Labour market has been resilient – Strong corporate earnings driven by artificial intelligence (AI) spending – Wage growth is moderating to sustainable levels	– Stock valuations have become challenging – Inflation remains sticky – Economic data have been surprising to the downside – Political uncertainty is heightened
Japan	O	– Economic growth is improving – Corporate governance continues to gradually improve – BoJ remains more accommodative – Yen weakness is a tailwind for export businesses	– Sentiment may have peaked – BoJ may become more hawkish due to higher inflation prints – Yen weakness creates volatility and uncertainty for domestically oriented businesses
Asia Pacific ex-Japan	N	– Macro data in China are marginally improving – Sentiment is turning more positive, albeit from depressed levels – In Australia, government support to the economy is a net positive. The housing market and rebounding commodity prices support the wealth effect	– Prolonged China deflation remains a concern – China property market issues are dampening consumer confidence and activity – Australia consumer spending shows signs of weakening on the back of a weaker job market – The Reserve Bank of Australia (RBA) could pivot to a more hawkish tone given sticky inflation
Emerging Markets	N	– Macro data and sentiment are marginally improving – Equity valuations are attractive relative to the US – Regulatory concerns are easing	– Chinese property deleveraging continues to weigh on activity – Chinese consumer and business confidence are fragile – Meaningful fiscal stimulus measures appear unlikely

U Underweight N Neutral O Overweight

Views are informed by the Asset Allocation Committee and regional investment committees (United Kingdom, Europe, Australia, Japan and Asia) and reflect the equity market.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2024

▼ or ▲ Month-Over-Month Change

		Change	*Underweight*		*Neutral*	*Overweight*		**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 CLASSES	Equities					■		Earnings continue to be driven by AI spend but face elevated expectations and moderating growth. Potential for broader market participation if economic conditions remain favorable.
	Fixed Income			■				Yields remain attractive, but volatility could persist due to global divergence in growth, inflation and central bank expectations. Credit fundamentals remain supportive; however, spreads remain tight.
	Cash	▲				■		Cash provides attractive yields as the yield curve remains inverted and offers liquidity should market opportunities arise.
	Region							
EQUITIES	US					■		Earnings growth expectations are dependent on continued AI momentum, as economic activity has yet to broaden. Technology and pharmaceutical innovation remain key differentiators. However, valuations may limit upside from here.
	Europe ex-UK			■				European equity valuations remain relatively attractive, but economic activity has bottomed. A further catalyst may be needed if market sentiment remains focused on tech innovation.
	UK				■			Equity valuations are appealing versus history and against major peers. However, domestic factors, such as a resilient labour market and Brexit adjustments, are inflationary. The forthcoming election in July may add to volatility.
	Japan					■		Economic indicators are reaching new highs in this cycle, while corporate governance improvements continue to support Japanese company fundamentals.
	Developed Asia ex-Japan[1]			■				In Australia, government support to the economy is a net positive. However, consumer spending shows signs of weakening on the back of a weaker job market and the RBA could pivot to a more hawkish tone given sticky inflation.
	Emerging Markets				■			Emerging market stock and currency valuations are both attractive, while China government policy is also supportive. However, geopolitical tensions with the US could rise.
	Style and Market Capitalisation							
	Global Growth vs. Value[2]			■				Continued economic resiliency and further broadening of equity market performance could be supportive for value. Cyclical strength and improving prospects for energy demand should be positive for value-oriented sectors.
	Global Small-Cap vs. Large-Cap[2]				■			Small-caps offer attractive relative valuations but are more challenged by higher-for-longer interest rates. Profit margins and leverage are also becoming more of a concern, warranting a higher quality bias.

Past performance is not a reliable indicator of future performance.

[1] Includes Australia.

[2] 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.

The asset classes across the equity and fixed income markets shown are represented in our multi-asset portfolios. Certain style and market capitalisation asset classes are represented as pairwise decisions as part of our tactical asset allocation framework.

EUROPEAN INVESTMENT COMMITTEE POSITIONING

As of 31 May 2024

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.

		Underweight	*Underweight*	*Neutral*	*Overweight*	*Overweight*	Change	
FIXED INCOME	Euro Government Bonds		■					Euro government bonds remain under pressure as monetary policy expectations are repriced. The ECB could adopt a gradual easing path.
FIXED INCOME	Euro Inflation Linked				■			Inflation is expected to ease further as the economy slows down. The labour market, however, remains tight.
FIXED INCOME	Euro Investment-Grade (IG) Corporates			■				Euro investment-grade credit is looking less attractive in terms of valuations, given the tight nature of spreads.
FIXED INCOME	US IG Aggregate		■					Stubborn inflation and a resilient economy could see the US Fed keep rates higher for longer than the market currently expects. Meanwhile, investment-grade spreads remain tight.
FIXED INCOME	Global High Yield				■			Attractive absolute yield levels remain supportive, but spread compression is limited from here. Default rates are likely to rise to historical long-term averages, although much appears to be priced in.
FIXED INCOME	EM Dollar Sovereigns				■			Yields look modestly attractive. With central banks embarking on easing cycles and inflation continuing to moderate, EM bonds may benefit.
FIXED INCOME	EM Local Currency				■			Central bank easing and lower inflation could be tailwinds, but a higher-for-longer Fed could sustain dollar strength.
FIXED INCOME	EM Corporates			■				We currently prefer to overweight emerging market sovereigns rather than corporates as credit spreads may widen as the global economy slows.
CURRENCIES	EUR vs. USD		■					With inflation receding more quickly in Europe, the ECB has moved earlier than the US Fed in cutting interest rates, increasing the interest rate gap between the two currencies in favour of the US dollar.
CURRENCIES	EUR vs. JPY			■				The yen remains a safe-haven currency, and current valuation levels are attractive. Any hint of policy change by the BoJ could support a stronger yen.

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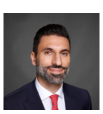
The specific securities identified and described are for informational purposes only and do not represent recommendations.

EUROPEAN INVESTMENT COMMITTEE



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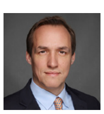

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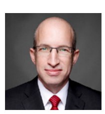

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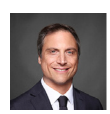

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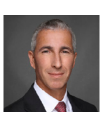

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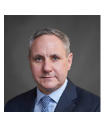

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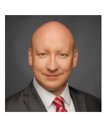

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T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so that they can feel more confident.

Additional Disclosure

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