Global Asset Allocation: The View From Europe

July 2024

1 Market Perspective

- Global growth remains broadly resilient with some signs of cooling along with easing inflationary pressures.
- Recent data across consumer, labour and businesses point to a moderation in US growth. European growth is stable, helped largely by services. The growth outlook in Japan is improving, albeit still muted, while stimulus measures in China targeted at the housing market help underpin the growth outlook.
- The US Fed remains patient as recent data suggest that tight policy may finally be weighing on growth. The European Central Bank (ECB) has taken the lead on easing policy, with more cuts likely. Despite weaker recent growth, the Bank of Japan (BoJ) is still expected to take additional steps towards tightening.
- Key risks to global markets include a steeper decline in growth, stubborn inflation, the election calendar, central bank policy divergence, geopolitical tensions and the trajectory of Chinese growth.

2 Portfolio Positioning

As of 30 June 2024

- We remain modestly overweight equities, as valuations beyond narrow leadership remain reasonable and economic growth, while slowing, is still supportive for earnings.
- We maintain an overweight to cash relative to bonds. Cash yields remain attractive with less aggressive expectations for Fed cuts, and cash provides liquidity should market opportunities arise.
- Within fixed income, we increased the underweight to government bonds because yields remain under pressure and maintained the overweight to inflation-linked bonds to hedge against sticky inflation.
- Within fixed income, we continue to favour higher-yielding sectors including high yield and emerging markets bonds as fundamentals remain broadly supportive.

3 Market Themes

Oh Snap!

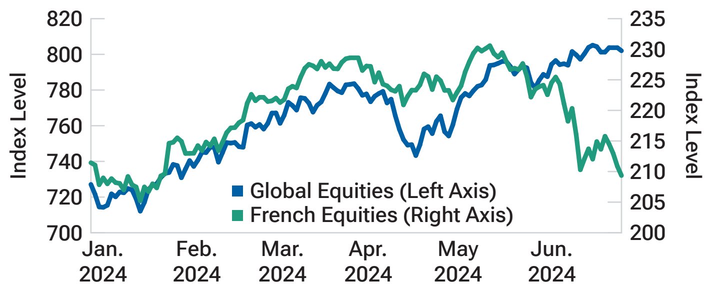
While investors were already expecting the possibility for heightened volatility around a packed global election calendar, those risks have only been amplified with the recent snap elections in France and the UK. Discontent with incumbent leaders has been a common theme leading to several opposition party wins, with economic, trade and immigration policies and corruption also contributing to voter dissatisfaction. The uncertainty associated with these elections could aggravate an already fragile global economic environment on the cusp of finally reining in inflation and skirting a more severe downturn. With the potential for abrupt changes in fiscal policies, trade and tariffs on the horizon, markets could become increasingly volatile as they weigh the impacts. Some of this is already playing out across European markets, which appeared to be turning the corner economically just weeks before recent snap elections were announced. With more elections to come and the increasing uncertainty around the US elections that are still months out, the uncertainty itself could become an increasing downside risk to growth and one leading to central bankers regretting not snapping at the opportunity when they had it.

Uptight

While other major central banks have taken the leap in cutting rates, including the ECB and Canada this past month, the Fed remains patient despite mounting evidence of slowing US economic growth. With cracks in the data starting to form across the ever-resilient US consumer, particularly among lower incomes, and the large pandemic savings buffer now depleted, consumer spending that had helped underpin inflation may finally be waning. The business sector, too, is starting to show cracks with recent declines in new orders and shipments. This weakness amongst consumers and businesses could quickly turn on the tight labour market, which itself has shown recent signs of cooling, as quit rates and job openings have fallen. And while the Fed's preferred gauge of inflation, core personal consumption expenditures, remains above their 2% target, incoming data may soon become hard to ignore as it tilts the balance of risk away from sticky inflation and towards weaker growth. Let's hope the Fed isn't too "uptight" about getting it wrong on inflation for a second time and won't end up being the party crashers for the economy.

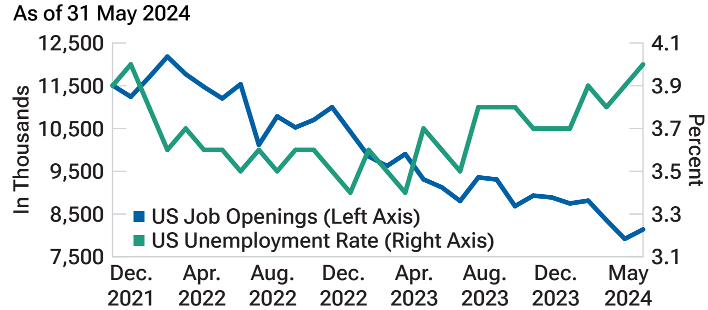
Election Uncertainty Causing Market Jitters[1]

As of 30 June 2024



Letting It Get Away?

As of 31 May 2024



Past performance is not a reliable indicator of future performance.

Source: Bloomberg Finance L.P.

[1] Global equities are represented by the MSCI ACWI. French equities are represented by the MSCI France Index.

REGIONAL BACKDROP

		Positives	Negatives
Europe	U	– ECB has started cutting rates – Inflation has been steadily declining – Economic sentiment is improving	– Economic growth remains weak – Geopolitical uncertainty is further heightened by French elections – Earnings growth remains weak, with minimal tailwinds from innovative technologies
United Kingdom	N	– Monetary policy is expected to ease – Inflation has been steadily declining – Economic growth outlook is improving	– Fiscal consolidation may need to be accelerated – Tight labour market could keep wage inflation stubbornly high
United States	O	– Strong corporate earnings are driven by artificial intelligence (AI) spending – Wage growth is moderating to sustainable levels – Recent inflation reports have been favourable	– Stock valuations have become challenging – Inflation remains sticky – Economic data have been surprising to the downside – Political uncertainty is heightened
Japan	O	– Economic indicators point to a reflationary environment – Weaker yen helps Japanese export companies – Corporate governance improvements are resulting in stronger company fundamentals	– Political uncertainty is likely to increase – Monetary policy remains accommodative – Ongoing yen weakness creates uncertainty
Asia Pacific ex-Japan	N	– Macro data in China are marginally improving – Investor-friendly regulation can further support confidence – 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 – Low appetite for policymakers to implement meaningful stimulus measures – Australia consumer spending shows signs of weakening on the back of a weaker job market risk that the Reserve Bank of Australia (RBA) turns more hawkish, given sticky inflation
Emerging Markets	N	– Macro data are marginally improving – Export-led sectors are benefitting from global economic recovery – Investor-friendly regulation in China should provide support	– Chinese property deleveraging continues to weigh on activity – Chinese consumer and business confidence remain 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 30 June 2024

▼ 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		Neutral	Overweight		Change	
ASSET CLASSES	Equities				■			Earnings continue to be driven by AI infrastructure spending but face elevated expectations and moderating growth. Potential for market broadening if economy improves; however, elevated valuations may limit upside.
	Fixed Income		■					Despite recent shift downward, yields remain at attractive levels. However, 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.
EQUITIES	*Region*							
	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		■					Valuations remain relatively attractive and economic activity has bottomed. While the majority of earnings of large European companies comes from overseas, the aftershocks of the elections in France may add volatility.
	UK			■				Valuations are appealing. However, a resilient labour market and Brexit adjustments are inflationary. The new Labour government is expected to be fiscally prudent.
	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 positive. Consumer spending is weakening as the jobs market also softens. The RBA could pivot to a more hawkish tone, however.
	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. Meanwhile, growth stocks face elevated expectations and challenging valuations.
	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.

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[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 30 June 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.

		Change	Underweight		Neutral		Overweight	
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.
	Euro Inflation Linked					■		Inflation is expected to ease further as the economy slows down. The labour market, however, remains tight.
	Euro Investment-Grade (IG) Corporates				■			Euro investment-grade credit is looking less attractive in terms of valuations, given the tight nature of spreads.
	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.
	Global High Yield					■		Overall yield levels remain attractive, 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.
	EM Dollar Sovereigns					■		Yields look modestly attractive; however, higher-quality sovereign spreads look tight. Central banks embarking on easing cycles and inflation continuing to moderate are supportive.
	EM Local Currency					■		Central bank easing and lower inflation could be tailwinds, but a higher-for-longer Fed could sustain US dollar strength.
	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 Fed in cutting interest rates, increasing the interest rate gap. However, the dollar is not cheap and a benign economic environment could be supportive for the euro.
	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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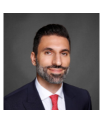
The specific securities identified and described are for informational purposes only and do not represent recommendations.

EUROPEAN INVESTMENT COMMITTEE



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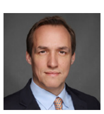

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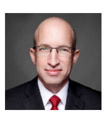

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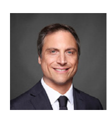

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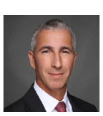

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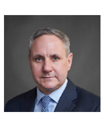

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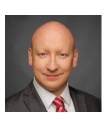

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T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so that they can feel more confident.

Additional Disclosure

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