T.RowePrice

Global Asset Allocation: The View From the UK

August 2024

1 Market Perspective

- Global growth is showing increasing signs of cooling along with easing inflationary pressures.
- Recent data across labour markets, consumers and businesses are pointing toward moderating US growth. European growth is supported by services, while manufacturing lags. Japanese growth is expected to rebound from a contraction earlier in the year. China extends stimulus measures to support housing and to the consumer to stabilise growth. UK economic growth seems to be resilient.
- There are growing concerns that the Fed may be behind on rate cutting amid more evidence of slowing growth. The European Central Bank (ECB) maintains a dovish stance, with further cuts expected. The Bank of Japan (BoJ) rattled markets with a surprise rate hike, despite soft economic growth. The Bank of England (BoE) has cut despite services and wage inflation remaining above levels of 5%.
- Key risks to global markets include a steeper decline in growth, central bank policy missteps, the election calendar, geopolitical tensions and the trajectory of Chinese growth.

2 Portfolio Positioning

As of 31 July 2024

- We remain modestly overweight equities with the recent pullback broadly improving valuations. While markets remain concentrated, valuations beyond narrow leadership are reasonable with earnings growth supportive.
- We maintain an overweight to cash relative to bonds. Cash yields still remain attractive and they provide liquidity should market opportunities arise.
- Within equities, we remain overweight value based on more attractive relative valuations. Value is likely to benefit from easing monetary policy, while growth faces the hurdle of higher expectations.
- 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

You're Killing Me, Smalls

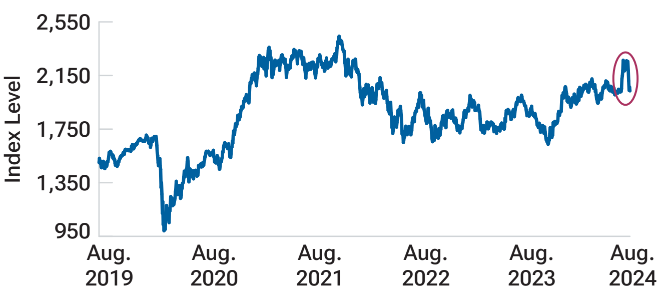
Going into the recent Fed meeting, anticipation for the bank to signal that it was nearing the start of rate cuts led small-caps to outperform larger counterparts by 10% for the month. Unfortunately for those small-cap investors, who have long been waiting for a recovery in a space held captive by higher-for-longer rates, those gains were quickly killed. The next day's weak jobs report and the untimely move by the BoJ reversed the market narrative around impending rate cuts being supportive for small-caps to instead reflect that it is too late to help an already weakening US economy. The worse-than-expected jobs number follows other recent data suggesting weakness in manufacturing and consumer finances. The view that small-caps' vulnerability to higher interest rates would now be allayed amid lower rates has been overwhelmed by concerns about their economic sensitivity, which the market now seems to be prioritising. With the prospects of a soft landing now in question, it's less likely that interest rate cuts alone will be sufficient to fuel small-cap outperformance until we see clear evidence that growth is going to be stabilised.

Getting Carried Away

The unfortunate timing of the BoJ's surprise interest rate hike last week, colliding with the Fed's decision to delay the start of cutting rates the day before disappointing US labour market data were released, sent global risk assets plummeting. Japanese equities were among the hardest hit after having been the darlings of the developed markets since last year on improving investor sentiment and reflation hopes. The sharp move lower in Japanese equities was exacerbated by the dramatic move higher in the yen as investors scrambled to get out of carry trades where they were short the lower-yielding yen and long other higher-yielding currencies. The yen carry trade has been a longtime favourite and crowded trade where significant leverage can be deployed, making today's unwind concerning as investors could be taking substantial losses as they are forced to buy back yen at much higher levels. This unfortunately comes at a time when the market narrative for US growth has changed just as quickly with fears that the Fed may be behind the curve, and it likely has made the Fed and BoJ's jobs a lot harder than they already were.

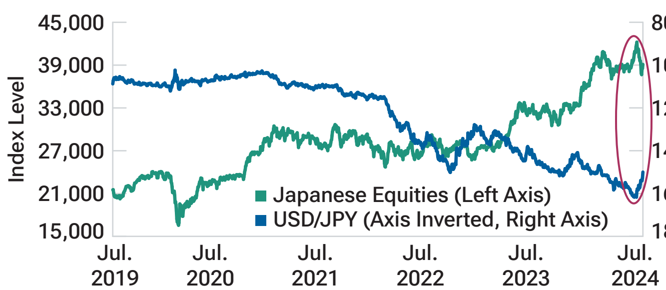
Small-Caps Crash Into Growth Fears[1]

As of 7 August 2024



Carry Unwind Hits Japanese Equities[2]

As of 31 July 2024



Past performance is not a reliable indicator of future performance.

Source: Bloomberg Finance L.P.

[1] Small-caps are represented by the Russell 2000 Index. Please see Additional Disclosures for more information about this Russell sourcing.

[2] Japanese equities are represented by the Nikkei 225 Index.

REGIONAL BACKDROP

Region	View	Positives	Negatives
United Kingdom	N	– The BoE has cut its policy rate – Inflation has been steadily declining – Economic growth outlook has stabilised	– Fiscal consolidation may need to be accelerated – Tight labour market could keep wage inflation stubbornly high
Europe	U	– The ECB has started cutting rates – Inflation has been steadily declining – Economic outlook has stabilised	– Economic growth remains weak – Geopolitical uncertainty remains heightened – Earnings growth remains weak, with minimal tailwinds from innovative technologies
United States	O	– Monetary policy expectations are improving – Corporate earnings are strong – Wage growth is moderating to sustainable levels – Recent inflation reports have been lower	– Stock valuations have become challenging – Inflation remains sticky – Economic data have been surprising to the downside – Political uncertainty is heightened
Japan	O	– Economic indicators are pointing to a reflationary environment – Corporate governance improvements are resulting in stronger company fundamentals	– The BoJ has hiked its policy rate – Yen volatility is creating uncertainty
Asia Pacific ex-Japan	N	– Macro data in China are marginally improving – Monetary easing in China is part of an incremental loosening approach – In Australia, the housing market and rebounding commodity prices support the wealth effect	– Prolonged China deflation remains a concern – China property market issues are dampening consumer sentiment – A slowing job market in Australia is impacting consumer spending. The Reserve Bank of Australia (RBA) could turn more hawkish, given sticky inflation
Emerging Markets	N	– Export-led sectors are benefiting from improving global trade – Monetary policy is loosening in many emerging markets	– 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.

UK INVESTMENT COMMITTEE POSITIONING

As of 31 July 2024

Underweight — *Neutral* — *Overweight*

▼ or ▲ Month-Over-Month Change

		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 CLASSES	Equities				■		There is potential for market broadening on expectation of Fed cuts; however, elevated valuations may limit upside. Concerns about peaking artificial intelligence (AI) spending and economic uncertainty could remain headwinds.
	Fixed Income		■				Short-end yields are biased downward on weaker growth and moderating inflation driving dovish central bank expectations. Credit fundamentals remain supportive; however, spreads remain tight.
	Cash				■		Despite a recent shift downward on the back of expectations for central bank cuts, cash still provides attractive yields as the yield curve remains inverted and offers liquidity should market opportunities arise.
	Region						
EQUITIES	US				■		Valuations are elevated, particularly for mega-cap tech stocks. However, monetary policy easing could stimulate broader earnings growth. Technology and pharmaceutical innovation remain key differentiators.
	Europe ex-UK		■				Valuations remain relatively attractive, and economic activity has bottomed. However, economic growth remains weak.
	UK			■			Valuations are appealing. 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. 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 amid a softening job market. The RBA could pivot to a more hawkish tone.
	Emerging Markets			■			Emerging markets stock and currency valuations are both attractive. China government policy is also supportive. However, geopolitical tensions with the US could rise.
	Style and Market Capitalisation						
	Global Growth vs. Value[2]		■				Easing monetary policy expectations should be supportive of rate-sensitive sectors. Meanwhile, growth stocks face elevated expectations, challenging valuations and growing AI skepticism.
	Global Small-Cap vs. Large-Cap[2]			■			Small-caps offer attractive relative valuations but are more challenged by cooling economic growth backdrop. Small-caps could continue to benefit from a dovish tilt in Fed expectations.

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.

UK INVESTMENT COMMITTEE POSITIONING

As of 31 July 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.

	Asset	Change	Underweight	Underweight	Neutral	Overweight	Overweight	
FIXED INCOME	UK Gilts			■				Recovering economic activity, persistent services inflation, accelerating quantitative tightening, large gilt issuance and US spillovers may keep yields under pressure.
	UK Inflation Linked					■		Inflation indicators (services, wages) remain elevated, although the UK labour market has eased a little.
	UK Investment-Grade (IG) Corporates				■			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 cutting rates fewer times than the market expects. Meanwhile, investment grade spreads remain tight.
	European IG Aggregate			■				Expectation of higher global rates and dynamics of quantitative tightening may weigh on European rates. Credit spreads could widen if the economy slows down.
	Global High Yield					■		Overall yield levels remain attractive, fundamentals remain supportive and default expectations are expected to remain near historical levels. However, upside beyond carry from further spread compression is limited.
	EM Dollar Sovereigns					■		Yields look modestly attractive; however, higher-quality sovereign spreads look tight. Central banks are easing, and moderating inflation is supportive.
	EM Local Currency					■		Central bank easing and lower inflation could be tailwinds, along with increasing prospects of a rate cut.
	EM Corporates				■			We currently prefer to overweight emerging market sovereigns rather than corporates, since credit spreads may widen as the global economy slows.
CURRENCIES	GBP vs. USD					■		In a benign market environment, the US dollar may soften, particularly from current expensive levels.
	GBP vs. EUR					■		The ECB is likely to cut rates more than the BoE to support economic growth.
	GBP vs. JPY	▼			■			Interest rate differentials continue to favour the GBP. However, given recent volatility in the yen because of the hike by the BoJ and unwinding of the yen carry trade, we prefer to remain neutral.

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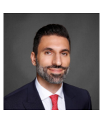
The specific securities identified and described are for informational purposes only and do not represent recommendations.

UK INVESTMENT COMMITTEE



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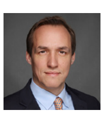

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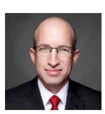

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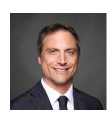

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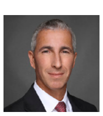

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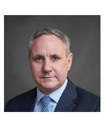

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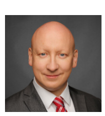

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INVEST WITH CONFIDENCE™

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 Disclosures

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