Global Asset Allocation Viewpoints and Investment Environment

DECEMBER 2019

1 Portfolio Positioning

As of 30 November 2019

Paring Back on Defense

- With increasing signs of global growth stabilizing, sentiment has improved for risk assets. However, we do not expect a sustained acceleration in growth from current levels.
- Within fixed income, we further reduced exposure to long U.S. Treasuries that performed strongly as a defense amid global recessionary fears.
- With still modest growth expectations, we remain overweight higher yielding assets - high yield and EM bonds - given limited potential upside for capital appreciation.
- Despite the recent rally in cyclically-oriented equities, we remain modestly overweight growth given our tempered expectations for growth over the near-term.

2 Market Themes

As of 30 November 2019

Let's Get Cyclical

Cyclical stocks have had an impressive comeback since September, outperforming defensive stocks as investors have become increasingly more confident in the global economy. Trade war abatement, improvement in economic data and higher bond yields have allowed sectors such as financials and industrials to recover, while other more rate-sensitive sectors such as utilities and real estate have lagged. Global equities outside the U.S., which are more trade-dependent, have also seen a pick-up as progress in trade talks has improved sentiment. Although it is difficult to identify catalysts that can support a sustained rally in cyclicals, this recent turn could have a bit more upside, as a potential Phase I deal could boost global risk-taking.

What Lies Beneath?

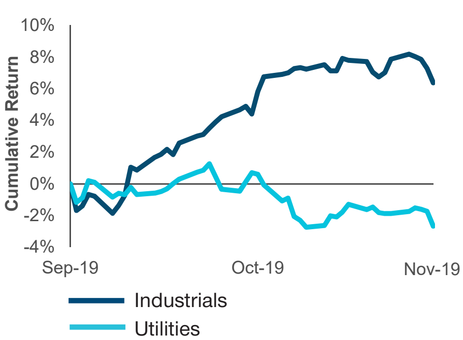
While equity markets are reaching all-time highs, investors in the lowest-quality portion of the high yield market (CCCs) are demanding the highest credit spreads in over three years. A range of challenges, such as secular shifts in consumer spending and low commodity prices, are weighing on some lower-tier companies, causing their spreads to balloon. Fortunately, the broader high yield market has seen its overall quality increase in recent years, with BBs making up nearly half the market. These higher-rated high yield bonds have seen spreads rally to multi-year lows amid increased central bank liquidity, stabilizing global growth, and demand for yield. While the risks among CCCs appears contained for now, these companies, particularly those needing to refinance, will be increasingly vulnerable to an economic downturn.

Changing of La-Garde

As markets question the effectiveness of monetary policy and its diminished range of tools, particularly in the eurozone, the new European Central Bank (ECB) chief, Christine Lagarde, is calling for a new policy mix to combat slowing economic growth and weak inflation. With interest rates already at extremely low (negative) levels and bond-buying back, she believes it is an attractive time for countries to increase fiscal spending to provide another means to boost growth. This is easier said than done, as countries with budget surpluses, such as Germany and the Netherlands, have been reluctant to increase their debt levels. If it does materialize, fiscal spending could augment monetary policy by increasing the number of bonds available for the ECB to purchase. Going forward it will be increasingly challenging for Lagarde to unify and grow a currently fragmented and fragile European economy through monetary policy alone. Her political savvy may be the ECB's best new tool.

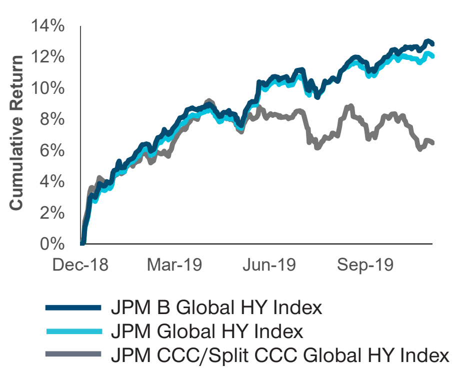
MSCI ACWI Index Industrials vs. Utilities

30 September 2019 through 30 November 2019



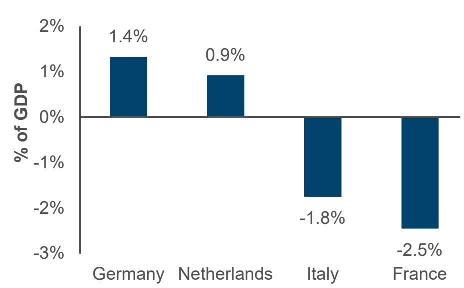
Global High Yield Index Bifurcation

31 December 2018 through 30 November 2019



Fiscal Surplus/Deficit

As of 31 December 2018



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3 Regional Backdrop

As of 30 November 2019

United States

Positives

- Fed likely on hold, inflation low
- Growth stabilizing
- Healthy consumer spending, strong employment, and improving wages
- Low interest rates driving a modest rebound in housing
- Greater share of secularly advantaged companies (e.g., cloud computing, internet retail) than rest of the world

Negatives

- Political uncertainty
- Modest economic growth with fading fiscal stimulus
- Muted near-term earnings expectations
- Weak capex spending and corporate confidence
- Late-cycle concerns: tight labor market, rising wages, and corporate margins under pressure
- Elevated corporate and government debt levels

Europe

Positives

- Monetary policy remains accommodative
- Beneficiary of trade-related supply chain disruptions
- Signs of stabilization in manufacturing
- Services sector of the economy resilient
- Dividend yields remain strong
- Political uncertainty moderating

Negatives

- Economic growth is challenged, with continued weakness in the manufacturing sector
- Limited scope for ECB to stimulate further
- Export weakness, vulnerable to trade and China growth
- Banking sector remains weak

Developed Asia/Pacific

Positives

- Stabilizing global economic outlook should be supportive for export-driven economies
- Accommodative stance from both the BOJ and RBA
- Broadly attractive valuations, particularly in Japan
- Improving corporate governance trends in Japan

Negatives

- Highly sensitive to global industrial production trends and trade tensions
- Market may be pricing in an unrealistic level of monetary support
- Earnings expectations falling in most markets

Emerging Markets

Positives

- Muted (but rising) inflation, supportive central banks
- Equity valuations attractive relative to developed markets
- With growing importance of tech sector, less tied to commodity cycle
- Beneficiary of further China stimulus

Negatives

- Export-driven economies are highly vulnerable to rising trade tensions
- Instability in several key markets could weigh on sentiment
- Long-term China growth trajectory remains a headwind
- China stimulus more measured and domestically focused
- Commodity prices remain under pressure

4 Asset Allocation Committee Positioning

As of 30 November 2019

▼ or ▲ Month-Over-Month Change

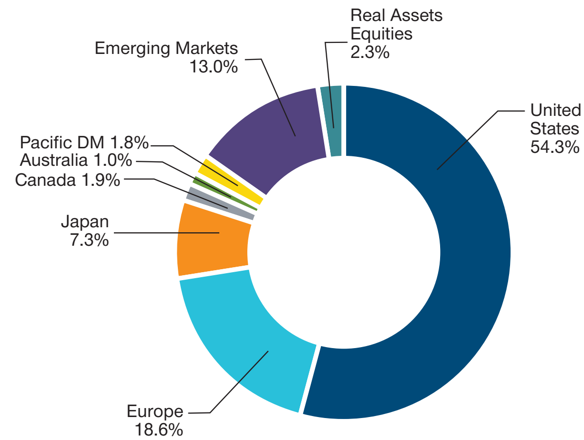
		Change	Underweight	Underweight	Neutral	Overweight	Overweight	**These views are informed by a subjective assessment of the relative attractiveness of asset classes and subclasses over a 6- to 18-month horizon.**
ASSET CLASS	Equities				■			Limited upside amid low global growth and modest earnings expectations. Above average valuations but still attractive relative to bonds.
ASSET CLASS	Bonds				■			Valuations extended with yields low due to growth concerns, trade uncertainty, and muted inflation; credit spreads tight, but near-term fundamentals supportive.
ASSET CLASS	Cash				■			U.S. yields most attractive among developed markets but past peak after recent cuts.
EQUITIES	*Regions*							
EQUITIES	U.S.			■				Earnings growth weak on margin pressure, and valuations above average; consumer and services sectors supportive, but weak demand from capex and exports.
EQUITIES	Global Ex-U.S.					■		Central banks remain supportive, and valuations attractive relative to U.S. amid concerns over manufacturing weakness and trade uncertainty.
EQUITIES	Europe				■			Growth outlook stabilizing but concerns over exports and banking system remain; potential tailwind from monetary stimulus.
EQUITIES	Japan				■			Monetary policy supportive but VAT increase a near-term headwind; export dependency remains the key driver with recent trends improving.
EQUITIES	Emerging Markets					■		Supportive monetary policies, attractive valuations, cheap currencies; susceptible to trade concerns and commodity weakness.
EQUITIES	*Style*							
EQUITIES	U.S. Growth					■		Secular growth companies less sensitive to macro environment; valuations elevated, and regulatory concerns persist.
EQUITIES	U.S. Value			■				Improved sentiment from depressed levels on fading recession concerns; still lack durable catalyst with modest economic growth and flat yield curve.
EQUITIES	Global Ex-U.S. Growth				■			Sector profile has defensive and quality growth bias, but valuations extended versus history.
EQUITIES	Global Ex-U.S. Value				■			Stabilization in economic outlook has improved sentiment; longer term headwinds remain from financial sector concentration, cyclical orientation, and trade.
EQUITIES	*Capitalization*							
EQUITIES	U.S. Large-Cap			■				Earnings outlook uninspiring with foreign demand a headwind; valuations trending above historical averages.
EQUITIES	U.S. Small-Cap					■		Valuations attractive and benefit from low rates and improving economic outlook, but high leverage and wage pressure are risks.
EQUITIES	Global Ex-U.S. Large-Cap				■			Stabilizing growth outlook and monetary policy supportive; but remain susceptible to trajectory of global trade.
EQUITIES	Global Ex-U.S. Small-Cap				■			Weak domestic growth trends and political uncertainty weighing on confidence in key markets.
EQUITIES	*Inflation-Sensitive*							
EQUITIES	Real Assets Equities		■					Stabilizing global growth outlook has supported commodities; however, inflation remains tepid and U.S. REIT valuations extended due to low rates.
BONDS	U.S. Investment Grade			■				Interest rates biased higher over the near-term amid stabilizing growth with corporate spreads remaining tight relative to history.
BONDS	Developed Ex-U.S. IG (Hedged)				■			Central banks supportive, and hedged USD yields attractive, but durations remain extended.
BONDS	Inflation-Linked				■			Inflation expectations remain low despite growth stabilization and central bank easing.
BONDS	Global High Yield					■		Yield carry attractive with near-term default expectations low. Vigilant on late-stage risks of credit cycle and weakness within lowest-quality segment.
BONDS	Floating Rate Loans					■		Yield level remains attractive, especially relative to high yield. Fed pause after mid-cycle adjustment is supportive.
BONDS	EM Dollar Sovereigns					■		Yields remain attractive and central banks supportive; turmoil in Latin America and potential contagion remain concerns.
BONDS	EM Local Currency					■		Yields attractive with currency valuations near extreme low levels; remain susceptible to political volatility and rising inflation expectations.

5 Portfolio Implementation

As of 30 November 2019

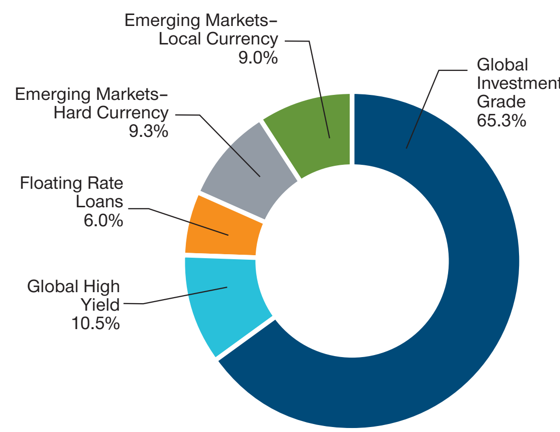
Equity	Neutral Weight	Tactical Weight	Relative Weight
United States	52.7%	54.3%	+1.6%
Europe	17.9%	18.6%	+0.7%
Japan	7.0%	7.3%	+0.3%
Canada	2.8%	1.9%	-0.9%
Australia	2.0%	1.0%	-1.0%
Pacific – Developed Markets	1.5%	1.8%	+0.3%
Emerging Markets	11.1%	13.0%	+1.9%
Real Assets Equities	5.0%	2.3%	-2.7%
Total Equity:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Fixed Income	Neutral Weight	Tactical Weight	Relative Weight
Global Investment Grade (Hedged)	70.0%	65.3%	-4.7%
Global High Yield	10.0%	10.5%	+0.5%
Floating Rate Loans	5.0%	6.0%	+1.0%
Emerging Markets – Hard Currency	9.0%	9.3%	+0.3%
Emerging Markets – Local Currency	6.0%	9.0%	+3.0%
Total Fixed Income:	**100.0%**	**100.0%**	

Tactical Allocation Weights



Source: T. Rowe Price.

Neutral equity portfolio weights broadly representative of MSCI All Country World Index regional weights; includes allocation to real assets equities. Core global fixed Income allocation broadly representative of Bloomberg Barclays Global Aggregate Index regional weights.

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Currency risk – changes in currency exchange rates could reduce investment gains or increase investment losses.
Default risk – the issuers of certain bonds could become unable to make payments on their bonds.
Emerging markets risk – emerging markets are less established than developed markets and therefore involve higher risks.
Foreign investing risk – Investing in foreign countries other than the country of domicile can be riskier due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments.
Interest rate risk – when interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
Real estate investments risk – real estate and related investments can be hurt by any factor that makes an area or individual property less valuable.
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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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