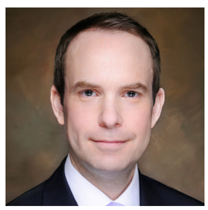
T. ROWE PRICE INSIGHTS
ON GLOBAL EQUITIES

No Normal Cycle, No Normal Recession

The short- and longer-term implications of the coronavirus on global equities.

May 2020



Laurence Taylor
Portfolio Specialist,
Global Equities

The crisis goes on, and much of the world remains in lockdown as the coronavirus continues to impact nearly every aspect of society. Financial markets, however, appear to have stabilized and perhaps are looking to the future. We have already seen the MSCI All Country World Index bounce 27.4% off its lows.[1]

Here, we look at the short-term impact on the economy and corporate earnings, but also at the potential long-term implications for inflation, style reversion, and de-globalization. Could unprecedented stimulus measures from central banks and governments spark a return of inflation, and hence a style reversion to value-oriented stocks? Also, does the transfer of supply chains back to individual countries help accelerate the pattern of de-globalization?

Short-Term Pain #1: Economies Set to Contract Dramatically

The global economy will enter a recession in the first half of 2020. The unprecedented freezing of global commercial activity in order to stem the spread of the virus is too powerful a force for economies to be able to withstand without a significant impact.

There is also the issue of employment and financing. Policymakers have recognized and acted with a speed and magnitude that few would have thought possible in "normal times."

But this will be a different kind of recession. This is brought about by a natural disaster, not a debt crisis or an economic or stock market bubble. We can't blame "bad bankers" this time, and certainly not bad "Silicon Valley," which is helping us through this crisis.

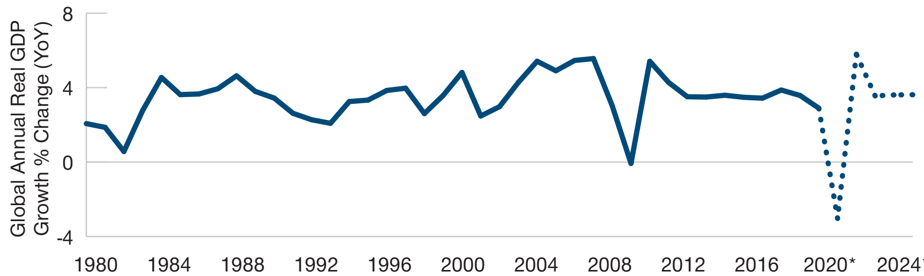
We expect to see disconcerting numbers coming out in the next few weeks and months. If people are unable to leave their homes, economic performance will be awful regardless of monetary or fiscal response. This is no normal economic cycle or recession.

> The global economy will enter a recession in the first half of 2020... But this will be a different kind of recession.

[1] Source: Refinitiv Thomson Reuters (see Additional Disclosure). As of April 30, 2020. MSCI International All Country World Index (Price) performance in U.S. Dollars from March 23, 2020 to April 30, 2020.

Coronavirus—A Monumental Economic Impact

(Fig. 1) But expected to be short term in nature, providing hope for the future



As of March 31, 2020.
Sources: International Monetary Fund (IMF)/Haver Analytics.
*2020–2024 represent IMF estimates.

…when we analyze the prospects for stocks individually and collectively, we are thinking much more about normalized earnings into 2021 and onward.

One cause for optimism is that this contraction should be sharp, but short. Pent-up demand, active fiscal policy, and low rates mean that we may see a more rapid recovery from the 2020 crisis than from the 2008–2009 financial crisis.

Short-Term Pain #2: Forget Corporate Earnings for 2020

As first-quarter earnings start to come through, we are already seeing the impact. Corporate earnings are going to be ugly and unpredictable. We believe we need to look beyond the current 2020 price/earnings (P/E) ratio numbers as they are unlikely to be a good indicator of future returns.

How do you manage a portfolio if you have no visibility on earnings? It will be difficult, but that is where experience and resources come to the fore. At T. Rowe Price, when we analyze the prospects for stocks individually and collectively, we are thinking much more about normalized earnings into 2021 and onward. What those projected earnings are and how quickly stocks normalize their earnings power will be the keys to recovery. Here, we are optimistic that an equity cycle can be born again from the improvements we expect to occur over the medium term.

For now, surviving the near-term cash imbalance between incomings and outgoings is much more important than P/E levels. Valuations are not defensive in the near term at current levels, but the durability of balance sheets and business models is supportive. Some dividends may be lowered, but if you believe that earnings will recover, and in the meantime, you may receive an average 2% dividend yield from equities while you wait for that recovery, then we believe that is an acceptable outcome.

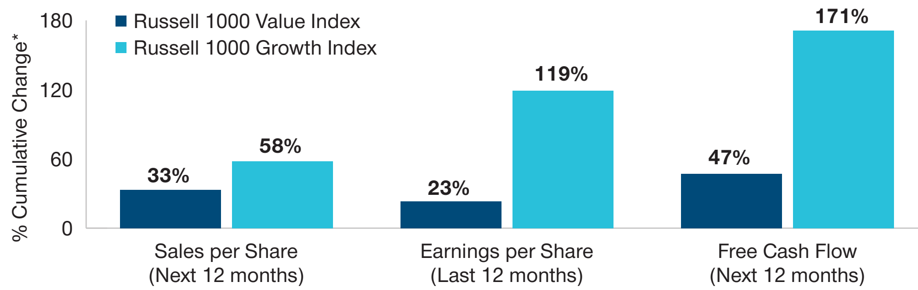
While the current earnings season will act as a source of stock dispersion and volatility, we believe the market has done a decent job of writing off a lot of earnings power in 2020. If we are wrong about the pace and magnitude of the earnings recovery, then the recovery may be less "V shaped" and more prolonged. The nature of the recovery ultimately depends on the extent and speed of lifting social and economic restrictions over time.

Long-Term Implication #1: Inflationary and Deflationary Forces Collide

It appears intuitive that some sort of political and societal change will result from the current restrictions being applied to both society and economies. While uncertainty abounds, most of these forces appear inflationary in nature.

An Era of “Growth” Dominance

(Fig. 2) Factors exist for potential change, but we believe a style reversion is still some way off



*Cumulative changes represent differences between forward measures as of June 1, 2007 and March 31, 2020.

Sources: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Russell (see Additional Disclosure).

> “While the sheer strength of growth versus value may create a catalyst for this balance to adjust in the near term, we still struggle to see how a value complex can attain longer-term superiority...

Accelerating de-globalization, nationalism/populism (immigration control included), and a mass fiscal experiment to send money directly to individuals from the government would all imply higher inflationary stimulus over time.

If raising wages for society via helicopter money and fiscal deficits can be done once (albeit with the catalyst being a national emergency), the question as to whether governments can do it again to raise real wages (given that wages have stagnated for 12 years, which is the crux of populism) is a sensible one.

The forces opposing higher inflation should not be underestimated, however. Technology continues to unlock capacity, while surplus natural resources and aging demographics remain powerful deflationary forces. These are large and secular trends that will not be steamrolled by fiscal policy with ease.

Long-Term Implication #2: Style Rotation and More Opportunity for Value and Cyclicals?

In terms of market style leadership, growth has materially outperformed value-oriented stocks through this crisis, which is intuitive given the relative impact of economic pain. As markets have risen, investors appeared to have doubled down on dispersion between the two. As a result, combined with the last 10 years of outperformance for growth, we now sit amid a truly unprecedented cycle for growth stocks. Unprecedented in length, but also in the sense that it is supported by incredibly strong fundamentals on the growth side of the equation.

A value cycle emerging would clearly have to have some of its foundations embedded in inflationary forces—forces that have been missing for over a decade. But, if stimulus does indeed push inflation higher, and we must recognize the unprecedented levels of central bank and government measures implemented so far, then a value cycle could finally be spurred on.

While short term in nature, we last experienced a shift to value in 2016, when it looked like economic growth and, subsequently, interest rates might normalize. However, this failed to materialize due to the long-term secular forces that we have spoken about extensively.

While the sheer strength of growth versus value may create a catalyst for this balance to adjust in the near term, we still struggle to see how a value complex

The coronavirus and the resulting focus on countries being able to be more self-sufficient seems set to accelerate the de-globalization trend.

can attain longer-term superiority in this prevailing environment without changes on the inflation front. With interest rates practically at zero for many countries, and no inflationary impulses likely to emerge in the short term, we find it difficult to support a durable style reversion.

Our portfolios, however, have always had the scope to own cyclicals and undervalued stocks where there is a defined catalyst of improvement, and we continue to analyze any stocks that can help to smooth relative returns in the event of a more cyclically oriented rally.

But rather than look at just stocks with cheap valuations, our focus remains on individual companies that should see their fundamentals improve where their industries or end products see early normalization as we move back into a growing, but still subdued, inflation world. We remain open to changing our mind if the facts change, however, and will be working hard to understand the impact of this extraordinary period of government and central bank intervention, especially if politicians recognize societal approval for a second wave of stimulus in more normal times.

Long-Term Implication #3: Coronavirus Accelerates De-globalization

The coronavirus and the resulting focus on countries being able to be more self-sufficient seems set to accelerate the de-globalization trend.

One outcome of recent events is the question of supply chain security and the reliance on non-domestic production to meet the needs of society, especially in times of crisis. Think ventilators, personal protection equipment, and hand sanitizer and the struggles of individual governments to provide enough of these products.

The experience of medical equipment shortages, along with the existing U.S.-China friction, will make self-sufficiency a more important part of economic policy. Prioritizing domestic jobs and production could lead to non-trivial efficiency losses and slower productivity growth, but these forces are unlikely to be enough to cause inflation alone. This will be a significant issue for some business structures, however. Especially those with global supply chains as the focal point of populist policymakers.

Managing a Global Equity Portfolio in This "New Normal"

There is a growing likelihood that the first wave of fiscal stimulus will be met with a second wave when necessary. Near term, the outlook for global equities is still highly uncertain given the possibility of further drawdowns. No one rings a bell to signal the bottom of the market.

There remains a lack of clarity over the spread of the virus and the eventual decisions that will need to be made to balance a return to work alongside ongoing infection controls. Many signs point toward an ongoing normalization of economic activity in China from low levels, but we are monitoring the spread of the virus in parts of Asia where there are signs of a reemergence of infection trends.

In our portfolios, we haven't been hiding in defensive areas; we are not content to simply accept higher dividend yields where there is little prospect of meaningful earnings growth. Instead, we have been busy, and our turnover has been higher as a result. In our view, waiting for the backdrop to improve is not the best way to capture returns, and some of the easy opportunities have already passed. We have been actively managing risk and making decisions for both the short-term improvement we see and the longer-term changes we expect to materialize.

We have been adding to secularly growing companies that we believe will be beneficiaries of the change

“...we feel optimistic over the medium term (12–24 months) that a new bull market can potentially be born from equity valuations that are lower, as we see stabilization and then normalization of economies.

that is coming. We are gearing for a long-term change where people travel less; technology is adopted more (e-commerce, automated factories); and health care companies are seen with new, positive eyes as aids to societal normalization.

Such changes will require thought and active management, given the disruptive nature on indices and presumed norms. Technology companies are also hiring huge amounts of staff to deal with the rise in demand, and this should help them be perceived in a better light compared with the villains they have been portrayed on Capitol Hill in recent years.

There are still significant and unpredictable risks to manage, and a measure of diversification remains key. Longer term, there are also real and unanswered questions of how governments will finance stimulus packages and how rising debt levels can be serviced. Despite the near-term uncertainty, we feel optimistic over the medium term (12–24 months) that a new bull market can potentially be born from equity valuations that are lower, as we see stabilization and then normalization of economies.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. Prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

China—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

Malaysia—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

Singapore—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

South Africa—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

ID0003206 (05/2020)
202005-1174699