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T. Rowe Price Midyear 2015 Market Outlook: Diverging Paths Of Developed And Emerging Markets Driving New Risks And Opportunities

Varying policy responses to the global financial crisis lead to more dispersion of returns in world markets; further volatility should be expected

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NEWS
Nearly seven years after the onset of the global financial crisis, economies around the world are still grappling with its consequences. The United States is leading the recovery, but its tepid growth has failed to reach the pace seen prior to the financial crisis. The responses of central bankers around the globe have led to wider dispersion of returns in world markets, with developed economies generally decelerating less than emerging economies—although emerging markets continue to grow faster. This environment requires a more selective approach to investing and presents more opportunities for active investment managers to add value to client portfolios.

More information about the T. Rowe Price Midyear 2015 Market Outlook, including contributor biographies and articles, can be found here.

MIDYEAR MARKET AND ECONOMIC OBSERVATIONS
Equity markets outside the U.S. generally outperformed the U.S. stock market in early 2015. This trend is likely to continue as the U.S. market is more richly valued and improvement in earnings potential is greater in non-U.S. markets, powered by improving economies in regions such as Europe and Japan.

The outlook for U.S. equities remains generally positive, but the market has seen a six-year bull run, including a rise in the Standard & Poor's 500 Index of more than 200% without a meaningful correction. As a result, investors should expect higher levels of volatility in the near term.

In emerging stock markets, some of last year's laggards have turned into some of 2015's best performers, suggesting that a rotation is underway. This has been especially true of Russia and China, which have both performed strongly thus far this year. Earnings expectations in several markets appear to have bottomed out, setting the stage for acceleration in places such as India and the Philippines.

Fixed income markets are wrestling with a high level of uncertainty owing to recent turbulence in many sovereign markets and unpredictable policy moves by many central banks. This makes for a wide range of potential outcomes as the year marches on. Investors are advised to consider the full range of securities to mitigate risk and optimize returns. The economic environment appears to favor high yield bonds because they generally have less sensitivity to rising interest rates than other bond classes.

The economies of the United States and the United Kingdom have deleveraged enough in recent years that their central banks are preparing to raise ultra-low interest rates. The U.S. expansion is intact, and growth in the eurozone is recovering faster than many expected. In addition, Japan's outlook is better as a result of delaying a tax hike.

Risks to the global economy include an unlikely hard landing as China's growth rate falls, a possible breakdown between Europe and Greece, and volatility resulting from unpredictable geopolitical events around the globe.

QUOTES FROM T. ROWE PRICE INVESTMENT PROFESSIONALS
Chris Alderson, Head of International Equity: "A better outlook for growth in the non-U.S. developed economies; signs that U.S. dollar appreciation has topped out; and aggressive monetary easing in Europe, Japan, and China have combined to lift the performance of non-U.S. equities in early 2015. Europe offers perhaps the best opportunity for an earnings acceleration in the second half, in our view, as economic growth forecasts have begun to pick up in core countries such as Germany and France and in most of the peripheral debtor countries, with the exception of Greece."

John Linehan, Portfolio Manager, U.S. Large-Cap Value Strategies: "Monetary policy should remain relatively supportive for equities, even as the Fed moves closer to its first interest rate hike in almost nine years. Earnings growth in the U.S. could be harder to come by given a mature economic cycle and a tougher environment for companies to improve profit margins. Sector and stock selection will become increasingly important moving forward."

Gonzalo Pangaro, Lead Portfolio Manager, Global Emerging Markets Equity Strategy: "Although valuations are not as compelling as they were a year ago, emerging markets overall are still trading at a discount relative to their history and they continue to look attractive versus their developed market peers. So far in 2015, there has been a rotation out of some of last year's best-performing markets into some of the laggards. We expect volatility to continue, so careful stock selection will be important."

Archibald Ciganer, Portfolio Manager, Japanese Equities Strategy: "Japanese equities have enjoyed a phenomenal ascent as quantitative easing, an improving corporate earnings outlook, and a weaker yen have all helped the market rise strongly. What is not yet reflected in the market is the improved competitiveness of Japanese companies, particularly in the technology sector."

Dean Tenerelli, Portfolio Manager, European Equities Strategy: "The European Central Bank, like its counterpart in Japan, adopted quantitative easing [QE] to turbocharge European economies and stave off deflation, giving a boost to sentiment from policy stimulus. Beyond QE, there is a clear concern in the market that there is no real fundamental bull case for European equities. However, this top-down perspective belies structural improvements we are seeing. Europe remains a diverse region with many high-quality companies possessing great pedigrees and robust balance sheets."

Arif Husain, Head of International Fixed Income: "We could be in for a pattern of sharp sell-offs followed by gradual rallies as Fed rate hikes come into closer view. After six years with a virtually 0% fed funds rate, any rate increase will be a paradigm shift. There are some markets that could provide refuge from interest rate volatility, including Asian markets such as China, South Korea, and Thailand."

Andrew Keirle, Portfolio Manager, Emerging Markets Local Currency Strategy: "The fundamentals of emerging markets debt issuers remain generally sound, as they typically have higher growth rates than those in most developed markets. Some Asian markets are recording economic growth rates in excess of 5%, while a number of European and Latin American economies are running at a more subdued pace. Despite continued dispersion in the performance of individual markets, emerging markets local currency debt offers relatively better value than what is available in developed markets."

Charles Shriver, Portfolio Manager, Global Allocation, Balanced, and Target Risk Strategies: "In response to global and regional economic trends, we've made several changes to our asset allocation portfolios in recent months, including increasing weights to non-U.S. equities and high yield bonds, moderating an underweight to non-U.S. bonds, and moving to a neutral position on emerging market bonds. Looking over the next six to 18 months, we are generally neutral between stocks and bonds. Corporate balance sheet strength and subdued cost trends are still supportive of stocks, while we expect monetary policy to remain relatively accommodative for some time among global central banks in order to promote economic growth."

Alan Levenson, Chief U.S. Economist: "Unprecedented central bank stimulus has had progressively less impact as the world endures a disappointing recovery from the global financial crisis. Varying policy responses to the crisis have led to a decoupling between improved conditions in developed nations awash in liquidity and slowing growth in emerging nations. Despite much anticipation, the Fed's first interest rate hike since 2006 should not have much of an economic impact, though global markets could react in the short term. Our base case is a hike of 0.25% by September, followed by a meeting-by-meeting assessment that should result in a very gradual path of further hikes."

ABOUT T. ROWE PRICE
Founded in 1937, Baltimore-based T. Rowe Price (NASDAQ-GS: TROW) is a global investment management organization with $772.7 billion in assets under management as of March 31, 2015. The organization provides a broad array of mutual funds, subadvisory services, and separate account management for individual and institutional investors, retirement plans, and financial intermediaries. The company also offers a variety of sophisticated investment planning and guidance tools. T. Rowe Price's disciplined, risk-aware investment approach focuses on diversification, style consistency, and fundamental research. For more information, visit troweprice.com or our Twitter, YouTube, LinkedIn, and Facebook sites.

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