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NEWS RELEASE

# T. ROWE PRICE 2020 MIDYEAR MARKET OUTLOOK: PATH AHEAD FOR FINANCIAL MARKETS DEPENDS ON HOW QUICKLY GLOBAL ECONOMIES NAVIGATE THROUGH PANDEMIC

*The global economy is mired in recession as the race continues for Covid-19 virus treatments and ultimately a vaccine that will allow business and society to return to normalized conditions. Equity and fixed income markets present a wide range of opportunities and risks to consider.*

**Baltimore: June 23, 2020**

**NEWS**

The longest equity bull market in history came to a sudden and shattering end in March as the Covid-19 pandemic killed hundreds of thousands of people worldwide, forced governments to impose a strict and prolonged quarantine of citizens, and plunged the shuttered global economy into recession. By mid-June, some countries began to emerge from quarantine, leading to concerns about a second wave, while some developing market countries continued to see a troubling rise in new infections. The global economy and markets are likely to remain volatile as scientists race to develop effective treatments and to deploy a vaccine in mass quantities, potentially sometime in 2021.

Equity markets around the world descended into bear market territory in March before rebounding in the second quarter due to unprecedented and coordinated government stimulus measures, optimism about the slowing spread of the virus in quarantined countries, the reopening of some businesses, and the hope for treatments and a vaccine. After plummeting by nearly 34% from its February peak to its low in March, the S&P 500 Index rebounded by nearly 40% by the middle of June, putting it in slightly negative territory for the year-to-date. Developed and emerging markets outside the U.S. experienced similar whipsaw results. The rebound sparked concerns that the equity markets have become unmoored from economic reality. T. Rowe Price managers see the potential for a pause or even a pullback at some point.

Government bond yields around the world rallied strongly as global central banks and fiscal authorities rushed to inject an historic amount of liquidity into the economy amid the panic, and as investors took flight to safe haven assets. The rally drove 10-year government bond yields below 1% in all major economies. Global high yield and emerging market bonds experienced market corrections in the first quarter before surging back with returns of 9.7% and 8.1%, respectively, in the first two months of the second quarter.

In managing to the other side of this crisis, T. Rowe Price managers are mindful that there remains significant uncertainty about the pandemic, which will likely lead to continued market volatility as businesses and consumers adapt to further disruptions in the global economy. The extreme dislocations in the financial markets present both risks and opportunities. T. Rowe Price managers favor companies that have top-flight management teams, rock-solid balance sheets, and strong competitive positions in their respective industries, qualities that could help them emerge from the crisis in strong shape.

In equities, the firm is finding compelling opportunities in the technology, health care, and energy sectors and in Asia ex-Japan companies. Companies on the leading edge of innovation continue to prosper as the digitization of a wide range of industries and markets accelerated during the pandemic. Conversely, industries in the crosshairs of the pandemic such as lodging, transportation, leisure, entertainment, and dining, must adapt their business models to a new normal, though even those industries present opportunities. With the robust rebound of the equity markets, valuations have become stretched and investors need to remain cautious in the short term.

In the fixed income universe, T. Rowe Price managers are focused on opportunities in credit sectors such as high yield and emerging market bonds. In high yield, they are overweight the cable, healthcare, and utilities sectors and are finding opportunities in beaten-up areas such as energy and metals. They are also adding to existing positions in high-quality cyclical companies.

Developing market governments and the International Monetary Fund have the capacity to support fundamentals and valuations in emerging markets bonds. Quantitative easing, a relatively new initiative in emerging markets, is most likely to help counties with strong balance sheets and credible fiscal institutions, such as South Korea, Thailand and Israel. The plunge in oil prices will be beneficial for oil importers like India, and detrimental for oil-exporting countries such as Nigeria and Venezuela. Markets are pricing in widespread credit distress, but many issuers are expected to recover in coming months even though there may be more defaults and increased volatility.

Despite the near-term uncertainty, the firm is cautiously optimistic over the medium term that a new bull market can potentially be born from lower equity valuations as the world moves toward eventual stabilization and normalization of global economies.

For more on T. Rowe Price's mid-year outlook, please read the article here.

**KEY 2020 MIDYEAR OBSERVATIONS**

- The near-term prospects for the financial markets depend upon several variables: the spread of the virus, the development of treatments to lower mortality rates, and ultimately, the development and mass deployment of a successful vaccine. There are signs both encouraging and disquieting: While cases of new infections are rising in some countries and remain stubbornly high in others, there has not been a second wave of the coronavirus as yet in countries that quickly quarantined. The firm anticipates that a vaccine could pass phase three clinical trials by early next year, sooner than initially expected. However, it could take months to get meaningful portions of the public vaccinated. Finally, there's the chance that the virus could resurface in the winter, though the world will certainly be much better prepared to take the necessary precautions to limit its spread.

- The digitization of a wide range of economies and industries has accelerated during the pandemic. As individuals around the world increasingly work, socialize, shop, and consume entertainment at home, companies that provide the infrastructure for the online economy have seen demand for their services boom, allowing them to extend their dominance.

- In health care, the longer-term impact of the pandemic could be that investors put an even greater premium on innovation and new drug platforms. The importance of drug development is likely to change public perceptions about the trade-off between innovation and drug pricing. If the regulatory overhang diminishes, valuations in the sector are likely to benefit.

- While energy was the worst-performing sector in the first quarter as the price of oil collapsed, there is potential for a powerful, counter-cyclical rally in crude oil and energy stocks over the next 12 to 24 months as low energy prices drive supply cuts and oil demand potentially recovers from an unprecedented shock. However, the longer-term outlook for energy stocks remains much less sanguine as ongoing productivity gains in U.S. shale fields should continue to make hydrocarbons easier and less expensive to extract.

- Despite a recent rally, the underperformance of U.S. value stocks versus their growth-oriented counterparts has widened since the outbreak of the pandemic, a trend that has been in place for a decade and likely will continue. While opportunities among value stocks are plentiful, the challenge will be to find companies that can make it to the other side of the crisis intact. T. Rowe value managers are finding opportunities in high-quality cyclicals, especially information technology and industrial companies that are developing innovative products, and in real estate and semiconductors firms.

- T. Rowe Price fixed income managers expect the credit default rate in this cycle, which reached a 10-year high of 4.8% in May, to peak at 10%. More than half of the high yield market today is rated BB, the highest percentage in history. Defaults among BB-rated bonds have historically been rare. There are some compelling opportunities in "fallen angels," formerly investment-grade bonds that had been downgraded to below investment-grade.

- The extreme and sudden impact of the pandemic on the global economy and financial markets has reduced confidence in traditional valuation metrics such as earnings and free cash flow because the current situation is so unique. T. Rowe managers are finding it difficult to compare aggregate valuation metrics to past periods. They are spending more time understanding the unique context of each individual company to properly assess valuation.

- The outlook for corporate earnings growth is murky as many companies, particularly those in industries most impacted by the quarantine measures, have eliminated or significantly reduced earnings guidance. With the economy entering a recession, we expect earnings growth in the near-term to be significantly challenged, with a return to earnings normalcy perhaps sometime in 2021.

- The second quarter will likely mark the nadir for economic growth, with U.S. gross domestic product (GDP) contracting by 12% in real (inflation-adjusted) terms. The U.S. created a somewhat surprising 3.1 million private sector jobs in May. For the year, T. Rowe economists expect a decline of 6.5% in U.S. real GDP. The International Monetary Fund is projecting a 3% contraction in the global economy this year.

**QUOTES**

Rob Sharps, Head of Investments and Group Chief Investment Officer

"The central question right now is whether equity markets have risen to unjustifiably high levels given the uncertain course of the pandemic. We've seen a dramatic recovery in a very short period of time, with some equity indices at breakeven or even at new highs for the year. There is certainly reason for optimism due to the slowing spread of the virus in some countries, the progress toward treatments and ultimately a vaccine, the stimulus, and the reopening of economies. But there's still a lot we don't know about the trajectory of the disease. Certain parts of the market have become quite highly valued, including small- and mid-cap companies, internet-enabled businesses, mobile communications platforms, and software as a service. So, we may be due for a pause or even a pullback."

"The pandemic has accelerated the shift to the digital economy. Since March, people have dramatically altered the way they work, socialize, shop, and access entertainment. People who were previously uncomfortable with technology have come to rely upon it. As a result, the longstanding trends toward mobility, e-commerce, and cloud computing have become further cemented in our daily lives. This has further strengthened the position of the big technology platforms and other companies that are on the right side of change."

"The pandemic has accelerated the backlash against globalization that had emerged before the crisis. Tensions have worsened between the U.S. and China. Global corporations are going to re-evaluate their supply chains to diversify their exposure to key countries and vendors. Nations will revise their policies around the procurement of vital medical equipment, such as ventilators. Finally, the increasing focus on environmental, social and governance issues will compel companies to choose their business partners ever more carefully. Nevertheless, we believe the long-term benefits of globalization are too compelling for it to be reversed in any meaningful way."

Justin Thomson, Portfolio Manager and Chief Investment Officer, Equity
"We have just seen the largest global stimulus package as a percentage of global assets in history. In the U.S. alone, we've seen Federal Reserve stimulus amounting to 29% of gross domestic product (GDP) and fiscal measures accounting for another 15.4% of GDP. In addition, this has been the most coordinated response to a crisis ever on a global scale, with central bank stimulus and fiscal programs implemented in the U.S., China, the Eurozone, and Japan. This is the primary reason why broad equity indices are flat or even up year-to-date."

"The latest skirmish in relations between the U.S. and China is the battle for hearts and minds in Hong Kong. Some observers are interpreting this as the gradual ending of Hong Kong's common law status and the 'one-country, two systems' principle. We believe it is not in China's interest for Hong Kong to lose its status as a global financial center. Much of Hong Kong's success has been based on its independent monetary system and particularly the pegging of the Hong Kong dollar to the U.S. dollar. There is no anticipation that the renminbi will be pegged to the dollar anytime soon. So, it is vital for China to maintain the integrity of the Hong Kong dollar."

"The equity bull market over the last decade has been led by growth stocks, large companies, and U.S. stocks, particularly the big tech platforms and other disruptors. That has continued since the pandemic, though recently there has been a reversion trade toward value over growth, small companies over their larger brethren, and non-U.S. stocks over their U.S. counterparts. However, we believe the trends propelling growth stocks before the pandemic, such as innovation and the move to a digitized economy, will continue."

Mark Vaselkiv, Chief Investment Officer, Fixed Income
"For the rest of this year and into 2021, we will witness a wide range of economic and market outcomes as the world recovers from the pandemic. What's unique about this recession is the enormous pain felt at the local level as small businesses have been closed. Half of Americans working in the private sector today are employed in companies with less than 500 people. How many of those small businesses survive is a key question."

"Despite rising federal deficits and the massive monetary and fiscal stimulus injected into the global economy, we expect inflation to remain muted for an extended period. We have seen stimulus injected into the economy since the global financial crisis of 2008, yet inflation has remained contained. This is due to strong and durable deflationary forces, including globalization, the decline in labor costs and wage growth due to new technologies, the secular drop in energy prices, and aging populations in major economies such as the U.S., China, Japan and across Europe."

"We're seeing extremely wide dispersion along the credit quality spectrum. After the initial panic in March, spreads have narrowed significantly in stable industries such as healthcare, but have remained fairly wide in challenged industries like retailing. Therefore, aggregate spreads today are less important than relative value analysis conducted on a case-by-case basis. Some industries, such as airlines, cruise ships, and energy are facing existential crises and will likely undergo financial restructurings. Many other sectors are well-positioned to benefit from changes in consumer behavior, such as health care, some media and broadcasting companies, quick-service restaurants, and supermarkets."

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