



The Risk Rally Will Likely Continue, but It Is Vulnerable

A price correction is possible.

February 2021

Since the U.S. elections, asset prices have risen steadily higher. Can the risk rally continue? I believe it can as it is underpinned by three powerful drivers. However, there are also three looming risks that could undermine it.

Three Primary Drivers of the Rally

Refocus on the Business Cycle

It is tempting to attribute the rally to the outcome of the U.S. elections. Personally, I think it has had less to do with the results of the elections than the mere fact that they have occurred, leaving the markets with one less thing to worry about. Leading up to the elections, investors had become so preoccupied with how different combinations of government would affect markets that they failed to notice that we are likely in the early stages of the next business cycle expansion.

Business cycle expansions are measured in years rather than months, and equities and credit tend to perform as the expansion unfolds. The passing of the elections left investors in search of a new narrative and, aided by good results from the vaccine manufacturers, their focus fell on the business cycle—and I believe this has been one of the drivers of the risk rally.



Nikolaj Schmidt
Chief International Economist



U.S. Stimulus Measures

The second driver has been the prospect of major stimulus in the U.S. Last year, the Federal Reserve adopted a “flexible form of average inflation targeting” that will enable it to keep monetary policy loose until there is a substantial improvement in the performance of the economy. Accordingly, given the ongoing challenges posed by the coronavirus, we believe there is little risk of policymakers even talking about tightening monetary policy until the second half of the year. Combined with the outcome of the Georgia senate election (which gave the Democrats control of Congress, making it easier for President Joe Biden to drive through major spending plans), the outlook for fiscal support has improved significantly.

...the next fiscal package should be... the closest we will ever come to helicopter money...

**...there is a risk
that we will not
be able to put the
coronavirus behind
us in 2021.**

Throughout 2020, the U.S. Treasury significantly raised the amount of cash it holds on its account at the Fed. In effect, this meant that the Fed was implementing quantitative easing while the U.S. Treasury engaged in quantitative tightening. We see significant scope for the U.S. Treasury to reduce its cash holdings at the Fed in order to finance the next spending package, and amid the winter wave of the coronavirus, we do not think the Fed will take any steps to sterilize this operation. In effect, the implementation of the next fiscal package should be fiscal expansion along with quantitative easing—the closest we will ever come to helicopter money (or modern monetary theory).



Vaccine Rollout

The last driver of asset prices has been the vaccine rollout. Investors live in the hope that by June we will—at long last—glimpse the coronavirus pandemic in the rearview mirror. Should we be so lucky, this would reduce uncertainty, set free the household animal spirits, and with that create an economic boom.

Three Key Risks That Warrant Investor Caution

Although the three drivers described above provide a strong foundation for risky assets, there are three lurking risks that should make us cautious.



Inflation Pressures Could Build

First, the Biden administration's planned fiscal expansion is extraordinarily large by any historical standard, and a big portion of the stimulus appears slated to filter through to the real economy in the late spring—exactly the time when we expect an organic bounce as coronavirus seasonality allows policymakers to roll back mobility restrictions. Could this lead to a rapid buildup of inflation and

financial stability pressures, bringing forward monetary policy tightening? It's possible, but I believe that the Fed will first pause and consider whether any increase in prices is a temporary bounce related to bottlenecks as the economy reopens, or genuine inflationary pressure from an economy that operates at full capacity. In any case, when central banks accommodate anything but very temporary inflation pressures, the currency tends to depreciate. This does not bode well for the dollar—a prime gauge of risk appetite.



Vaccines May Not Be the Panacea

The second major risk relates to the efficacy of the vaccines. On this front, the recent news flow has not been encouraging. There have been multiple mutations of the original coronavirus strain, prompting doubts over the efficacy of the current vaccines. Given that the virus will continue to mutate, there is a risk that we will not be able to put the coronavirus behind us in 2021. In my view, given the rapid buildup of long risk positions in the market, the exceedingly loose fiscal and monetary policy is unlikely to paper over cracks that originate from inefficacy of vaccines due to mutations of the virus. Indeed, should the need for additional fiscal support come to pass, the market likely will challenge the sustainability of the fiscal position of at least a few sovereigns in the emerging markets.



China's Stimulus Measures May Not Persist

Our third concern is China. The Chinese economy has staged a spectacular rebound from the coronavirus recession, and we have reached the point where policy stimulus is being rolled back. China is the world's second-largest economy by GDP and easily the largest economy if measured by real



...the path of
least resistance
is...for prices to
continue rising.

resource absorption. On the economic side, one of the key focuses of the decision-makers is to gradually bring the country back onto the deleveraging path to reduce any financial risks that, should they be mismanaged, could present challenges to the incumbent leadership. The authorities have indicated that they will be cautious to ensure that the tightening happens at a measured pace, but given the combination of the change in the credit impulse and historical track record of stop-go policies, we keep a keen eye fixed on China to make sure that indeed the pace of policy tightening is at a measured pace.

An Extension of the Rally Is the Most Likely Outcome

Risk markets have rallied a long way, and rallies come with inflated valuations and a buildup in investor positioning. Overall, however, I believe the drivers of asset prices outweigh the risks and that the path of least resistance is therefore for prices to continue rising. And although it is possible that such a buildup of risk positions will lead to a rapid price adjustment, I would be inclined to see a price correction—provided it is not accompanied by a worsening of one of the risk factors described previously—as an opportunity rather than a sign of something worse to come.



T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

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.

© 2021 T. Rowe Price. All rights reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the bighorn sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc.