T. Rowe Price

INVEST WITH CONFIDENCE

PANORAMA

QUARTERLY THOUGHT LEADERSHIP PUBLICATION FOR OUR CLIENTS

SECOND QUARTER, 2021

WELCOME……

………to the second quarter 2021 edition of Panorama, T. Rowe Price's investment magazine for Asian investors.

Global equities certainly performed well in the March quarter. The U.S. led with a 6.2% gain in the S&P 500, while the MSCI All Country World index rose 4.7% in U.S. dollars. Equities appear to have successfully digested a sharp rise in bond yields driven by rising growth and inflation expectations. With rich valuations, further equity returns in 2021 will depend on whether earnings can match consensus forecasts of a strong cyclical rebound in each region. The omens in this respect are good, with first quarter earnings in the U.S. off to a very strong start.

In our first article, global equity portfolio manager Kai Yoichiro explains why an equity dividend strategy is different from a growth or a value strategy, with surprisingly little overlap in opportunity sets. He takes a barbell approach, combining high yield dividend stocks and stocks with higher cash flow growth but a lower dividend yield. The skill is to blend stocks from these two buckets to identify a portfolio with an attractive yield and good growth opportunities over the cycle.

Our global fixed income team discuss investment opportunities in the rapidly expanding global high-yield bond market, as more companies in Europe and the emerging markets look to issue bonds. High yield can provide an advantage over other fixed income segments in a low-yield environment, though strong fundamental credit analysis at the individual security level is essential for success.

Global multi-asset portfolio managers Richard Coghlan and Chris Faulkner MacDonagh argue the coronavirus pandemic was not a classic recession. As such, investors may be missing the magnitude of the cyclical upswing in prices. With unexpected inflation a rising risk, this may be a good time to review portfolio allocations to inflation hedges like real assets, in case inflation remains 'higher for longer.'

Turning to Asia, China's dramatic V-shaped recovery from the coronavirus pandemic is widely recognized and applauded. But it is longer-term strategy and prospects that are more important for investors. Asia Sovereign Credit Analyst Chris Kushlis believes the rise of technology and innovation is a meaningful shift in direction for China that is probably underappreciated by the market.

Asia Credit portfolio manager Sheldon Chan explains how ESG integration can help to identify high-quality, forward-thinking businesses for investment and manage downside risks in credit portfolios. To earn a position in the Asia Credit Bond Strategy, each investment must satisfy a three-step process with ESG analysis embedded at every stage.

Finally, in our Personal Profile interview we spoke with Kai Yoichiro, the portfolio manager of T. Rowe Price's Global Dividend Equity Strategy, based in Tokyo. Income strategies suffered in the pandemic last year, but appear poised to come back strongly in 2021 as company earnings rebound.

As always, we welcome your comments and feedback and our contact details can be found on the back cover of the magazine.

Asian Institutional Team

GLOBAL DIVIDEND STOCKS: GREENER PASTURES LIE AHEAD

Yoichiro Kai
Portfolio Manager,
Global Equity Dividend Strategy

Dividend Investing Styles Suffered in 2020

Equity dividend or income strategies had a particularly difficult time in 2020 thanks to the deep if short-lived global recession triggered by the coronavirus pandemic. As a rule, listed companies are very reluctant to cut dividends other than in exceptional circumstances when they have few other choices. The reluctance of companies to lower dividends is largely because they fear a cut will be seen by shareholders and investors as a negative signal of management's confidence in the future prospects of the firm.[1] However, the unprecedented speed and depth of the collapse in global demand due to the national lockdowns and social distancing policies introduced to counter the coronavirus meant that many companies had little choice but to slash their dividends last year. In 2020 around 30% of the MSCI World Index's constituent stocks announced that they would cut dividends, the highest share of dividend reductions since the global financial crisis.

Given these widespread cuts in dividends in response to the pandemic, it is not surprising that dividend investing styles fell out of favor. The chart on the left in Figure 1 compares the performance of S&P 500 dividend payers with that of S&P 500 non-dividend paying companies in 2020 and in 1Q 2021. The right-hand chart makes the same comparison for

[1] For an early postwar analysis of the determinants of the dividend payout ratio, see J. Hirshleifer,"On the Theory of Optimal Investment Decision," Journal of Political Economy, 1958.

dividend growth stocks (proxied by the NASDAQ US Broad Dividend Achievers Index). Due to the unique circumstances created by the coronavirus pandemic, 2020 was the worst year for dividend payers versus nonpayers and for dividend growth stocks since 2009 and the global financial crisis. Driven by the market rotation into value, dividend payers in the first quarter of 2021 outperformed, clawing back some of the ground lost last year. In contrast, dividend growth stocks underperformed slightly in Q1 2021 as they were not favored by the switch to value. In 2020, three growth sectors - information technology, consumer discretionary, and communication services – accounted for 87% of the gain in the S&P 500. In the first quarter of this year, the same three sectors contributed just 20% to the gain in the S&P 500. Financials and energy, in contrast, two of the biggest drags on S&P 500 returns in 2020, had contributed over 50% to the index's gain in Q1 2021.

Sustained Global Recovery Favors Dividend Stocks

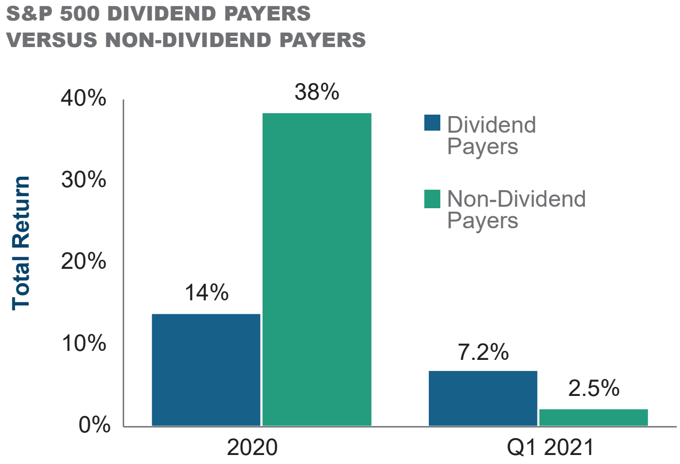
Overall, we think the investment environment should become a lot more favorable for global dividend/ equity income strategies going forward. With the global composite PMI (purchasing managers index) for manufacturing and services standing at a 6 1/2 year high in March, it is clear that a powerful cyclical recovery is now underway in the global economy. The International Monetary Fund in its April World Economic Outlook, for example, forecasts the global economy to grow by 6.0% this year, a dramatic turnround from last year's 3.3% decline. The global PMI for manufacturing is at its highest level in a decade as business sentiment rebounds. The rapid rollout of vaccines against Covid-19 in some countries has played a large part in the recovery of business, consumer, and investor sentiment. It is proving successful in rapidly reducing the number of new infections, raising hopes for an end to lockdowns and social distancing, in those countries that have been able to acquire sufficient supplies of the new vaccines.

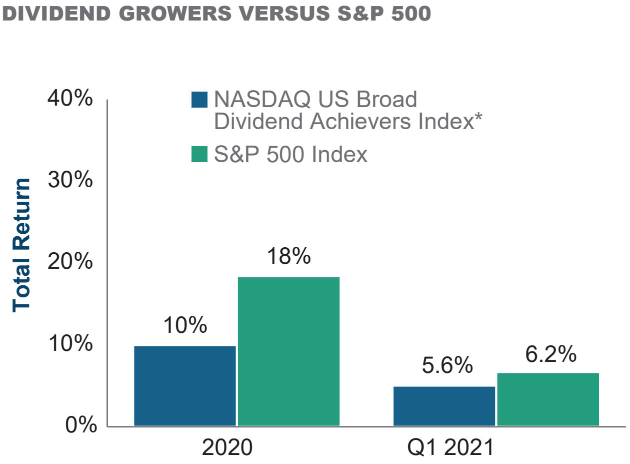
As a result, many economists expect a strong recovery in consumer services this year, until recently a lagging sector. In March the service sector PMIs for the U.S. and China, the world's two largest economies, both surprised on the upside, supporting their view. Global trade has also recovered much more rapidly than expected, and the volume of world exports is back above its pre-pandemic level. The unprecedented U.S. fiscal stimulus since 2020 has been big enough to have significant spill-over effects, boosting other economies. The World Trade Organization's April global trade forecast, for example, has U.S. imports expanding by over 11.0% this year after contracting 6.1% in 2020. Much of the extra U.S. domestic demand is expected to be met by Asian export manufacturers, including China. President Biden's USD2.0 trillion infrastructure plan also plays an important role in the global recovery scenario. It may greatly reduce the risk of a 'fiscal cliff' developing in the U.S. next year as the impact of the front-loaded USD1.9 trillion American Rescue Plan begins to fade.

A Strong Earnings Rebound Can Repair Dividends

We believe a strong cyclical economic recovery in 2021 and 2022 will feed through to company earnings. Many of the companies that were forced to cut their dividends during the pandemic crisis are likely to reinstate dividend payout ratios as economic conditions improve. Others, such as banks in a number of countries including the UK and Europe, were obliged by government pandemic

FIGURE 1: Greener Pastures for Dividend Investing in 2021?
Both dividend payers and growers significantly underperformed in 2020





Past performance is not a reliable indicator of future performance.
Source: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved.
*Comprised of US securities with at least ten consecutive years of increasing annual regular dividend payments.

emergency support measures to cut or refrain from paying dividends even though their fundamentals had not deteriorated that much, and they still had the ability to pay. There will also be companies in other sectors that in the pandemic cut dividends excessively, fearing a worst case scenario that did not materialise. There are also many companies with strong balance sheets and management in areas like consumer discretionary, transport, infrastructure, and entertainment that, although hit by the pandemic, are showing an ability to stage strong recoveries. In our view, some of these companies may only be yielding 1.0% today, but have the potential to raise their dividend yield (DY) over the next two to three years. The companies to avoid are the dividend cutters which already had issues and fragilities before the pandemic struck.

Threat from Higher Bond Yields May Be Less Than Consensus Imagines

Many investors expect bond yields to rise further this year under a strong recovery scenario. How vulnerable might dividend stocks be to a move higher in sovereign yields? The first point is that while the 10-year U.S. Treasury yield may have further to rise, the rate of increase is likely to slow. Forward Fed funds rates embedded in the futures market are already quite aggressive, with four 25 basis point increases expected in 2023. On adding a 50 basis point term premium (close to the current rate and its historic average), the 10-year bond yield would still be below 2.5% in 2024 compared to 1.56% currently (04/23/2021).

While global long-term rates may rise further, probably in steps, the important thing to know is how to manage a dividend equity strategy over rate steepening and flattening cycles. Traditional high DY stocks or 'bond substitutes' such as utilities, REITs, infrastructure, or telecom companies are likely to prove vulnerable if U.S. Treasury yields rise faster than the market currently expects (which may not be such a high probability scenario, based on the argument above). However, there are also cyclical growth dividend payers among banks, insurance, chemicals, commodity, or property stocks that historically have shown they can outperform in upcycles even as bond yields rise. Dividend stocks can even be found in the technology sector among semiconductor manufacturers and semiconductor equipment companies.

A key to reducing the interest rate sensitivity of the portfolio is to maintain a good balance between these two types of dividend stocks over the interest rate cycle. This lies at the heart of a dividend income strategy. As the economic cycle weakens and the yield curve flattens, one should have more stocks in the traditional high DY bucket. Conversely, one should have more cyclical growth dividend stocks during the economic recovery phase, when yield curves are steepening. Thus we tend to follow a dynamic barbell approach in which our weighted average DY stays much the same, but where the portfolio's interest rate beta or sensitivity varies over the cycle.

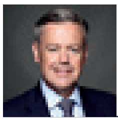
Historically, dividend cutting stocks have delivered lower total returns and higher volatility. In contrast, companies that pay a high or above average dividend combined with decent growth prospects can generate strong cash flow for investors, helping to act as a buffer or cushion to unexpected bouts of market volatility. In our view, the result of skillfully blending traditional high dividend yield stocks and dividend growth stocks has the potential to provide an attractive overall portfolio risk/return trade-off over the market cycle. We believe that after a difficult 2020, dividend payers and growers in future can continue to provide strong downside risk management and attractive risk-adjusted returns to investors over full market cycles.

In terms of investment themes among dividend stocks in 2021, the fundamentals of some utility stocks have improved, driven by the secular shift to renewable forms of energy. We believe these companies are positioned to achieve stable earnings growth besides possessing an attractive dividend yield. We also believe there is further room for banks to run as we think accelerating loan growth in 2021 is not fully priced in at current levels. We view that Banks are also beneficiaries of the trend toward higher global interest rates. Elsewhere in financials, property and casualty Insurance are poised to benefit from the rising residential property cycle as home price increases should flow through to margins and earnings. Durable, high-quality GARPY (growth at a reasonable price and yield) stocks have generally lagged behind this year, as investors favored other areas of the market. As a result, we think a number of these dividend growth names have the potential to offer attractive reward/risk profiles on a multi-year view.

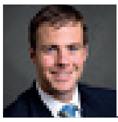
OPPORTUNITIES IN THE EXPANDING GLOBAL HIGH YIELD BOND MARKET

Non-investment-grade debt can provide attractive income.

- A global high income portfolio can offer an attractive combination of compelling yield and low exposure to interest rate risk.
- The high yield bond asset class includes some well-known issuers and is expanding rapidly as more issuers in Europe and emerging markets sell new bonds.
- An actively managed global high income portfolio seeks to benefit from divergent credit cycles, relative value disparities, and regional variations.



Michael Della Vedova
Co-portfolio Manager,
Global High Income Strategies



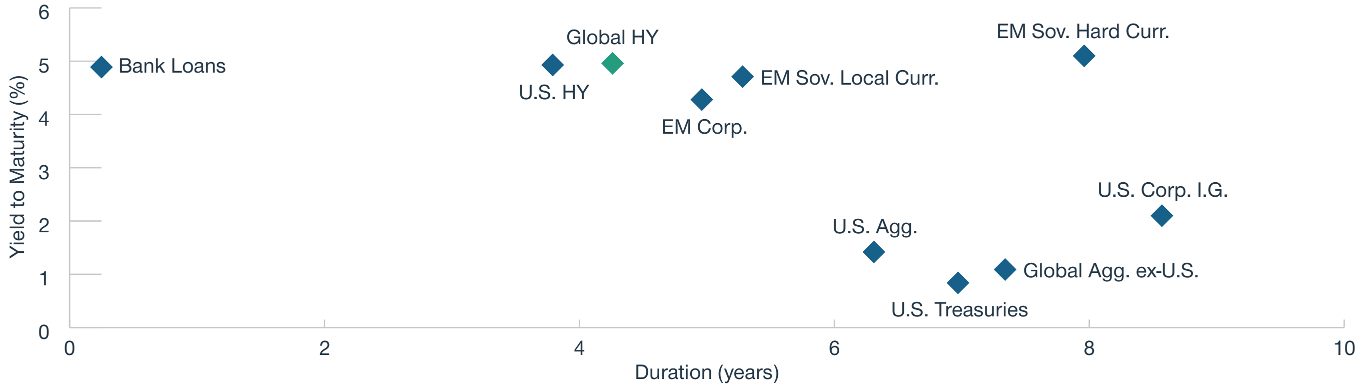
Michael Connelly, CFA
Co-portfolio Manager,
Global High Income Strategies

Samy Muaddi, CFA
Co-portfolio Manager, Global High Income Strategies; Portfolio Manager, Emerging Markets Corporate Bond Strategies; and Co-portfolio Manager, Emerging Markets Bond Strategies

Global high income portfolios can offer an attractive combination of compelling yield and low exposure to interest rate risk. This may provide an advantage over other fixed income segments in the current low-yield environment. The high yield bond asset class includes some well-known issuers and is expanding rapidly as more non-investment-grade issuers in Europe and emerging markets sell new bonds. Strong fundamental credit analysis at the individual security level is essential for success in the wide investable universe of global high yield bonds.

Many household names, including Kraft Heinz and Ford Motor, issue bonds in the global high yield market. Some prominent technology companies also have below investment-grade debt ratings and use the bond market to raise funds. Some of these firms, such as Netflix and Tesla, are best known for their highflying and sometimes volatile equities. However, it is important to note that debt ranks higher in the capital structure than equity.

FIGURE 1: Higher Income With Lower Duration
Duration and yield across fixed income sectors



As of February 28, 2021.
Past performance is not a reliable indicator of future performance.
Sources: Bloomberg Finance L.P., T. Rowe Price, and J.P. Morgan Chase (see Additional Disclosures).
Indexes used: U.S. Treasuries: Bloomberg Barclays U.S. Treasury Index; U.S. Aggregate: Bloomberg Barclays U.S. Aggregate Index; U.S. Corp. I.G.: Bloomberg Barclays U.S. Corp. I.G. Index; U.S. High Yield: Bloomberg Barclays U.S. High Yield Index; EM Sovereign Hard Currency: J.P. Morgan EMBI Global Diversified; EM Corporates: J.P. Morgan CEMBI Broad Diversified; EM Sovereign Local Currency: J.P. Morgan GBI EM GD Index; Global Aggregate ex-U.S. Index; Global Aggregate ex-U.S.: Bloomberg Barclays Global Aggregate Index (hedged to USD); Global High Yield: Bloomberg Barclays Global High Yield; Bank Loans: JPM Levered Loan Index.

Coupon Payments Primary Component of Returns

From January 1998 through December 2020, the average 36-month rolling annualized coupon return of the ICE BofA Global High Yield Index, hedged to U.S. dollars, was over 8%. This regular, predictable coupon return has been the main source of total return in the high yield bond market. Over the same time period, non-coupon return was about -0.9% annualized due to price changes and defaults, but income more than offset this more volatile component of total return.

With most global interest rates still at very low levels, the widely expected economic bounce back in the second half of 2021 could drive yields on high-quality government bonds meaningfully higher. This exposes most segments of fixed income to duration[1] risk because prices decline as yields increase. High yield bonds have lower duration than most other segments of fixed income, so the attractive income from non-investment-grade bonds does not come at the expense of the elevated interest rate risk in most other types of bonds.

Compelling Risk-Adjusted Historical Performance

High yield bonds also appear compelling in terms of historical risk and return. The average 36-month rolling Sharpe ratio,[2] a measure of risk-adjusted return, of the ICE BofA Global High Yield Index, hedged to U.S. dollars, from January 1998 through December 2020 was 0.82. This was meaningfully higher than the S&P 500 Index's 0.54 during the same period, indicating that global high yield bonds generated more return per unit of risk than U.S. stocks.

Global high yield bonds also provided lower exposure to major historical declines in U.S. stocks while participating in the majority of the subsequent recoveries in equities. From 1998 through 2020, there were 12 periods with declines of greater than 5% for the S&P 500. On average, the ICE BofA Global High Yield Index, hedged to U.S. dollars, experienced only 37% of the downside in stocks but participated in 44% of the recoveries that followed.

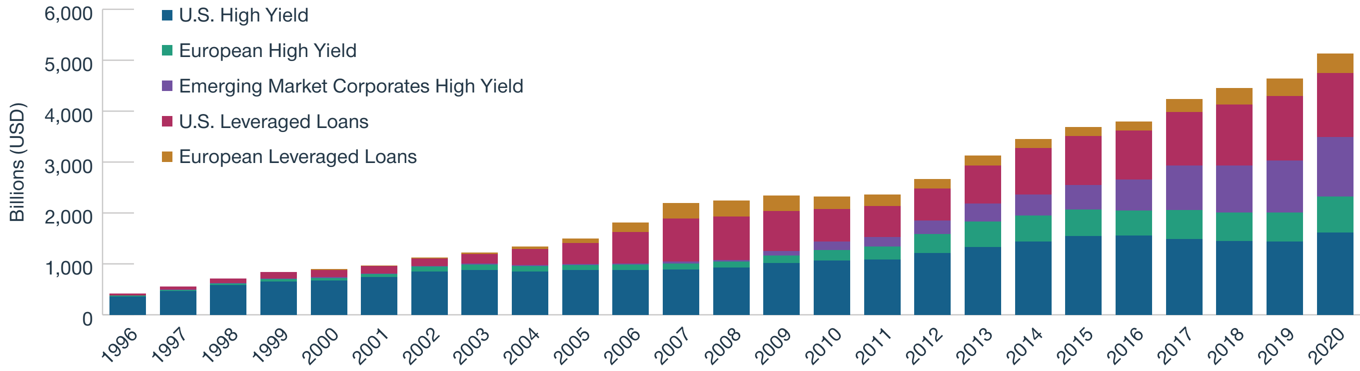
> *The high yield bond market is about five times larger than it was in 2000...*

Rapidly Expanding Investable Universe

The high yield bond market is about five times larger than it was in 2000 (Figure 2), and the investable universe has become much more global over the last 20 years. As shown in Figure 2, at the end of 2000, North American issuers made up 90% of the market. As of December 31, 2020, this had dropped to less than 60%, with emerging markets issuers accounting for 23% of the broad market and European issuers at 19%.

[1] Duration measures a bond's sensitivity to changes in interest rates.
[2] The Sharpe ratio is a measure of return relative to risk, calculated as an asset's return above the risk-free rate, divided by the standard deviation of the asset's excess return.

FIGURE 2: Rapid Expansion in High Yield Market
Market growth 1996 to 2020



As of December 31, 2020.
Sources: Credit Suisse, except J.P. Morgan for emerging market corporates (see Additional Disclosures).

This expansion has led to a more diverse opportunity set in the asset class in terms of both industries and economic cycles. Energy is the largest industry in the U.S. high yield market, financials is the largest weighting in Europe, and real estate issuers dominate emerging markets high yield.[3] Also, individual emerging markets may at times be at a different point of their economic cycle than Europe or the U.S., potentially creating additional opportunities for diversification that active managers can strive to exploit.

Fundamental Credit Research Is Essential

Working with this large investable universe, we rely heavily on the expertise of our global credit analysis team to select individual securities. Because macroeconomic and political developments—along with environmental, social, and governance (ESG) concerns—can have a large impact on the performance of international bonds, we supplement our fundamental credit analysis with top-down insights from our team of sovereign and ESG analysts. Their input is essential for developing regional allocations and can help us sidestep country-specific issues.

An actively managed global high income portfolio seeks to benefit from exposure to divergent credit cycles, relative value disparities, and performance variations between regions. There is also potential to profit from valuation dislocations driven by the ever-present economic and political uncertainties across the global landscape. It's also important to note that our Global High Income Bond Strategy hedges any foreign currency holdings back to the local currency, allowing our credit selection to be able to generate income potential.

WHAT WE'RE WATCHING NEXT

COVID-19 vaccination rates widely vary among countries and regions, likely allowing those with speedier vaccinations to reopen economies and return to growth before those that are lagging. These differences in economic cycle timing could create relative value opportunities for active high yield bond managers.

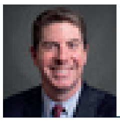
[3] U.S. high yield represented by the J.P. Morgan U.S. High Yield Index, emerging markets represented by the Bank of America/Merrill Lynch Emerging Markets Corporate High Yield Index, and Europe represented by the Bank of America/Merrill Lynch European Currency High Yield Const. ex. Sub. Fin. Index.

INFLATION LIKELY TO ACCELERATE: A NON-CONSENSUS VIEW

Aggressive stimulus, rapid labor market tightening and past underinvestment in commodities mean higher inflation is a risk.

- The consensus view sees inflation peaking around April or May and then remaining weak.
- We think this misses the magnitude of the likely rise in prices from aggressive stimulus, rapid labor market tightening and past underinvestment in commodities.
- Unexpected inflation is a risk. A review of allocations to inflation hedges like real assets may be considered in case inflation remains higher for longer.

Richard Coghlan
Portfolio Manager,
Global Multi-Asset Team



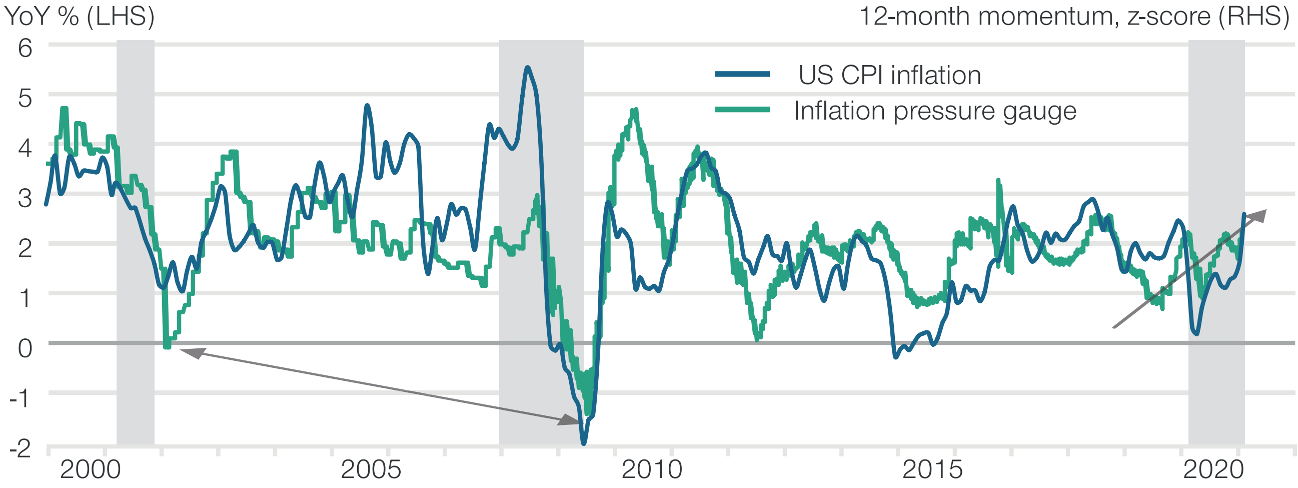
Chris Faulkner MacDonagh
Portfolio Manager,
Global Multi-Asset Team

Asset and commodity prices have been moving in line with the view that supply constraints and a weaker U.S. dollar are putting incipient pressure on underlying inflation trends. Contrary to the widely held consensus view, we believe inflation pressures are likely to accelerate substantially as 2021 progresses.

The consensus view is that inflation will peak around April or May of this year, largely because of base effects in which inflation has been weak immediately in the wake of the pandemic and energy prices have also slumped. Base effects alone are expected to lift headline Consumer Price Index (CPI) inflation by about 100 basis points to over 2.75 percent. If the headline CPI rises in line with history, annual inflation could conceivably top 3 percent by May.

FIGURE 1: Consumer Price Pressures Haven't Fallen As Much As In The Past

Headline CPI inflation & inflation pressures Z-score



As of 31 March, 2021.

Sources: Bureau of Labor Statistics/Haver Analytics; DeepMacro LLC Daily Inflation Pressure index.

Central bank officials have noted that they too expect inflation to drift up solidly in the coming months. Yet, they've indicated that they are going to look through this. Federal Reserve Chairman Jerome Powell recently expressed no concern about a sell off in bonds and provided no indication of policy changes ahead. The Fed has further indicated they are unlikely to act even if inflation rises temporarily to 3% to 3.5%. As a result, we expect markets will not get too excited about U.S. near-term inflation prints above 2 percent.

The consensus view that inflation is unlikely to accelerate is widely shared because inflation, particularly core inflation that the Fed focuses on, is usually suppressed after a recession, particularly one as deep as the COVID-19 recession.

Our view goes against the consensus. This was not a classic recession, and we think the market is missing the coming magnitude of the cyclical upswing in prices. The pandemic shock was not a classic end-of-cycle recession and the inflation response is likely to be quite different for five reasons:

- Starting conditions are not as bad as in previous recessions
- Rapid labor market tightening
- Past underinvestment in commodities
- A rising current account deficit
- Aggressive stimulus adding fuel to the fire

These five observations on inflation will be important to note for investors because we feel that markets are unprepared for and have not yet priced in a cyclical inflation shock. From the bond market, forward inflation swaps are still only pricing a muted inflation recovery. The five-year five year forward rate (5Y5Y) on inflation swaps is only around 2.4 percent. And this already includes the well-known rise in inflation because of base effects. Models of the inflation risk premium show that the compensation demanded for future inflation is near record lows from which it can only rise.

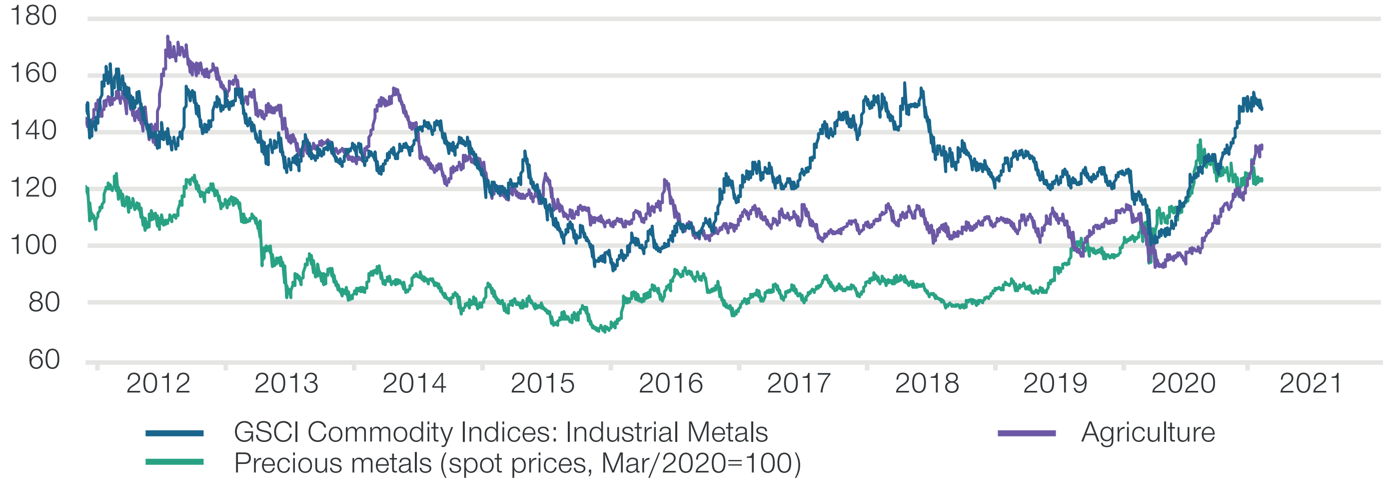
> *....forward inflation swaps are still only pricing a muted inflation recovery.*

Unexpected inflation is a risk for many investors who might have under-invested in real assets and other inflationary sensitive assets. A review of allocations to inflation hedges like real assets may be considered in case inflation remains higher for longer.

1. Starting conditions are not as bad as in previous recessions

The starting conditions for inflation are much stronger now than during past recessions. Headline CPI inflation appears out of step with its typical cyclical behaviour (See figure 1). In recessions, CPI inflation typically falls sharply, as does the broader price pressure indicator. In 2020, however, headline inflation only fell a little while broader measures of price pressures rose through the year. From this, we deduce sequential inflation may now rise significantly, especially since many commodity prices (food, metals, and energy) have increased 30 to 40 percent since Q4 2020, according to the GSCI Commodity Price Indices. Energy prices in particular feed rapidly into headline CPI inflation.

FIGURE 2: Non-oil Commodity Prices Rebounded Strongly in 2020
GSCI Commodity Indices: Industrial Metals, Agriculture, Precious metals
Spot prices, Mar/2020=100



As of February 18, 2021.
Sources: Standard & Poor's/Haver Analytics.

Demographic changes imply that the trend labor force participation rate is only around 1.5% above the current level. This leaves little scope for a large pool of labor to weigh on wages, unlike the labor market dynamics in the 2010s when the participation rate was higher. Any further improvements will continue to eat into current labor market slack, leaving the economy exposed to insufficient supply when demand returns, forcing employers to compete for labor via higher wages.

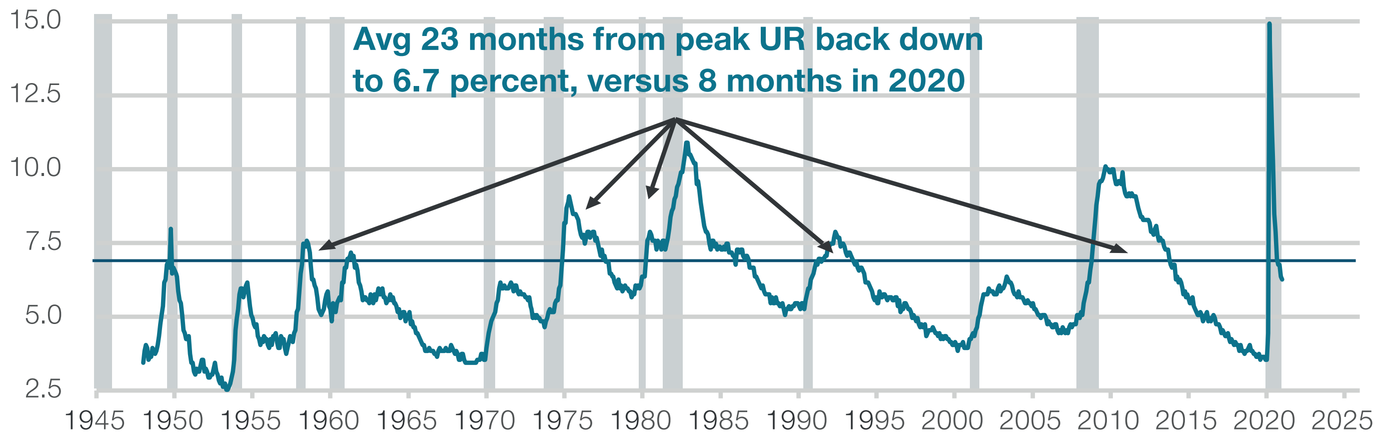
Estimates suggest that online shopping, working from home and other social changes triggered by the coronavirus have brought forward a decade of innovation. This has benefited companies on the right side of this change, but many businesses that were adversely affected have been shut permanently, reducing overall capacity. Cyclically, this has resulted in a very sharp fall in retail inventories, especially of autos. As demand recovers, we think the associated restocking could add over USD500 billion, boosting U.S. real GDP growth by 5-6 percent per quarter over several quarters, returning GDP to its pre-crisis trend level faster than many expect and closing the output gap.

> *Labor markets are currently tightening at an historically rapid pace....*

2. Rapid Labor Market Tightening

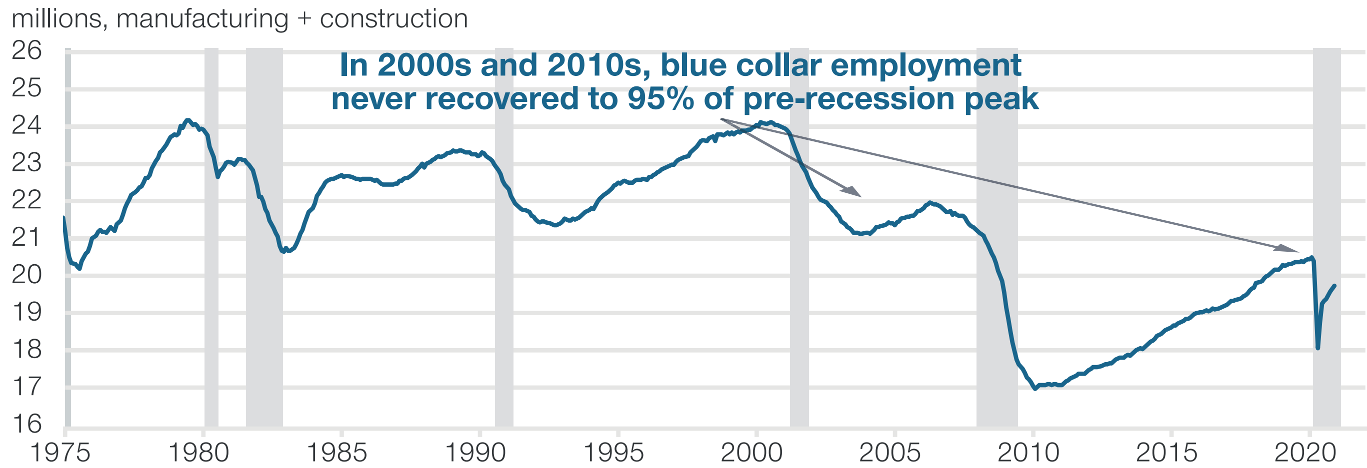
From a labor market perspective, the COVID-19 shock was very unusual compared to previous recessions. Traditionally, unemployment rockets higher but then falls like a feather during a typical

FIGURE 3: Fast Economic Recovery Should Support Inflation
Unemployment rate in percent
Horizontal line indicates current level of Unemployment Rate (UR)



As of February 18, 2021.
Sources: Standard & Poor's/Haver Analytics.

FIGURE 4: Wages Don't Face Big Pressure From Newly Unemployed
Blue-collar employment back at 95% of pre-COVID levels



As of February 18, 2021.
Source: Haver Analytics.

recession/recovery; rising sharply in the first three months of the recession, but then taking two years — or longer —to return to more normal levels of unemployment.

> *In 2020 it took only eight months for the unemployment rate to get back to 6.75%....*

Labor markets are currently tightening at an historically rapid pace, both thanks to rehiring as economies reopen and as an aging population leads to a shrinking working population. By any standard, the current unemployment rate of 6.75 percent is not typically seen until two to four years after the end of a recession (Figure 3). This time is different. In 2020 it took only eight months for the unemployment rate to get back to 6.75%, and it looks like it could be under 6 percent by mid-2021.

The pandemic shock is more like the recessions after WWII and the Korean War. Unemployment surged then, and professional economists worried that mass demobilizations would push us back into 1930s style deflation. However, what they missed was that these shocks induced large shifts that drove demand in sectors that had seen little investment. As a result, unemployment swiftly fell and inflation surged, as the postwar economy struggled to adjust to the lack of labor and inadequate supply in new areas of demand.

Finally, we would also observe that the pandemic shock was unusual because of who lost their jobs. Usually, the manufacturing and construction sectors—sources of skilled blue-collar labor—suffer the most and take the longest to recover. Indeed, after the 2001 and 2008 recessions, blue-collar employment never recovered, as proxied by the total number of workers in U.S. manufacturing. By contrast, in 2020, blue-collar employment has snapped back quickly.

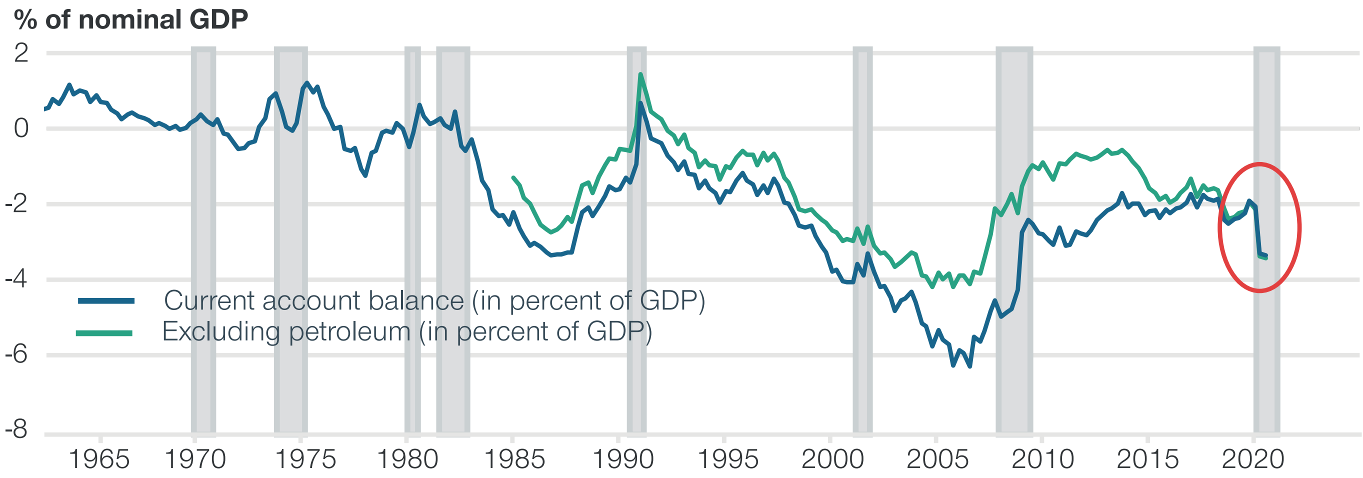
Consequently, we think there is likely to be less downward pressure on wages from high unemployment as compared to the 2000s and 2010s. In the first two decades of this century, many blue-collar workers were forced to take lower paying service sector jobs, competing with workers already in those industries and driving down wages. After the coronavirus shock, by contrast, manufacturing employment quickly recovered to over 95 percent of its pre-crisis level (Figure 4). With generous support from social security safety nets, the remaining unemployed blue-collar workers have fewer incentives to seek work in the COVID-exposed consumer services sectors like entertainment or hospitality at much lower wage rates.

3. Past Underinvestment in Commodities

The commodity sector has also seen weak investment in recent years, suggesting supply conditions could tighten further in 2021 as demand increases amid recovery. Capital discipline in the mining industry, for example, has limited new capex spending, providing producers with pricing power. There are few signs that the recent run-up in iron ore prices is prompting a capex response.

Investment in energy (as proxied by Baker Hughes rig count) has also been the weak. The shortage of oil rigs means U.S. oil production would be slow to respond to a recovery in demand. With current oil consumption about two million barrels (per day) above production, inventories are likely to start falling

FIGURE 5: U.S Current Account Deteriorated In A Recession
Current account balance in % of GDP (& Excluding petroleum)



As of February 18, 2021.
Source: Bureau of Economic Analysis/Haver Analytics.

quite rapidly. Moreover, the recent OPEC+ agreement brokered by Saudi Arabia shows a surprising degree of production discipline by oil producers, at least until midyear.

Given this discipline, commodity prices have unsurprisingly surged. These higher raw material input costs should start to feed into sequential inflationary pressures in the coming months.

4. Rising Current Account Deficit in Recession/Inadequate Supply

At the macro level, the widening U.S. current account deficit during a recession tells us there is insufficient domestic supply to meet domestic demand (Figure 5). Traditionally, the external balance improves during a recession, reflecting a shortfall of domestic consumption. Currently, however, consumption has accelerated beyond the ability of the economy to meet demand.

A continued rebound would inevitably see a further widening of the deficit, especially since the United States runs a deficit in autos (where there has been a key supply shortfall). At the same time, global capacity is also tighter than in the mid-2000s, as repeated rounds of Chinese supply cuts are leaving Chinese producers with less spare factory capacity. Also, most incremental investment today is going to service depreciation rather than new greenfield productive capacity. As a result, China may become less of a source of global deflation pressures than in the past.

5. Large Positive Fiscal Impulse in 2021

The recently signed American Rescue Plan Act of 2021 (also called the COVID-19 Stimulus Package) will accelerate the recovery even more as the relief provisions are overwhelmingly geared toward low-income and middle-class Americans who are more likely to spend. The USD1.9 trillion package will also be largely spent within 2021. We regard the U.S. economy as already closing its output gap and running tighter that many commentators suspect. These forces were already well in train before the initial impact of fiscal stimulus has been felt. We believe this very large positive fiscal impulse in 2021 will erode labor market slack ever more quickly.

> *We believe this very large positive fiscal impulse in 2021 will erode labor market slack ever more quickly.*

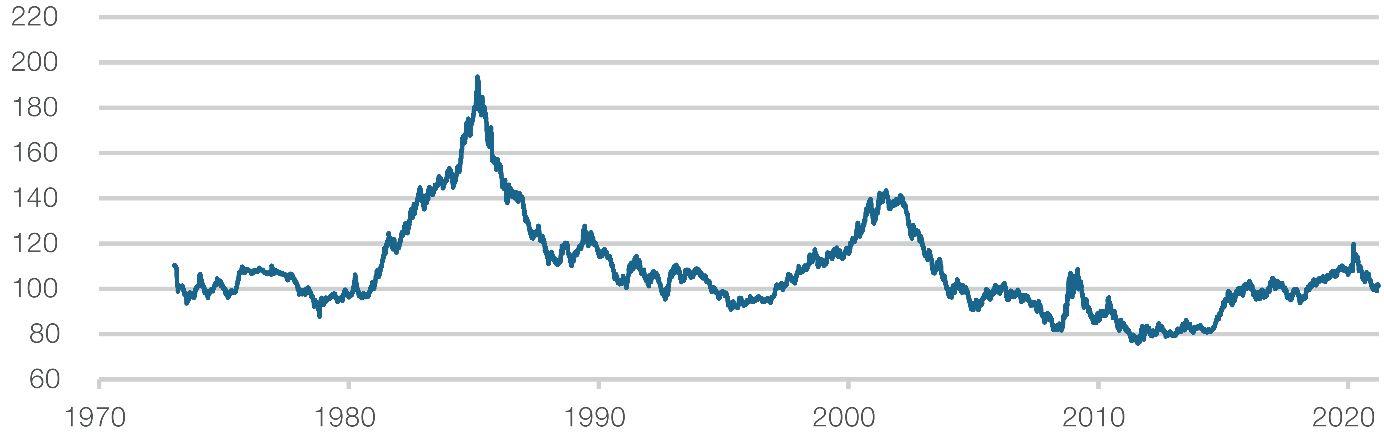
Internationally, non-oil commodity demand is strong, buoyed by the recovery in global trade and domestic Chinese demand, especially for infrastructure and housing which are expected to remain resilient in 2021. Globally, the quantity of fiscal stimulus has been less in the euro zone and China compared to America. While demand has slowed more sharply in Europe, Chinese growth has remained resilient and is already back to its pre-COVID-19 trend, which reduces the risk of deflation pressure building.

What are the Risks to our non-consensus view?

1. Vaccine versus mutations

In the near-term, renewed worries about the coronavirus could come back to weigh on economic activity. In Europe and China the authorities renewed travel and quarantine restrictions as new waves of infections peaked. There are worries that new mutations of the virus potentially could reduce the

FIGURE 6: External Weakness & Inflation Leads To A Weaker Dollar
The U.S. Dollar Factor, 1973 to present



As of February 18, 2021.
Source: Bureau of Economic Analysis.
[1] Total return index of an equally weighted basket of USD vs G10 currencies, rebased to 1973 = 100. Higher numbers = USD appreciation.

efficacy of vaccines, though so far there is thankfully no evidence of this.

2 Long-term trends

There have been significant structural forces that explain the low inflationary environment. Globalization, productivity enhancements in oil production and price discovery enabled by technology will not disappear anytime soon. This might lead to lower inflationary pressures than expected.

3 Chinese policy over-tightening

We are also watching credit developments in China as policy over-tightening there would be a key risk to the global inflation outlook. Globally, the coordinated central bank easing in 2020 saw a modest uplift in credit, but came on the back of fiscal stimulus that was four times the size of the fiscal boost during the GFC. This helped to buoy consumer spending and employment in 2020. Additionally, the mix of fiscal and monetary stimulus in developed markets is unlike the mid-2010s, when we saw fiscal tightening offsetting central bank easing—a mix that preempted an enduring recovery in commodities. The current policy stance if sustained in 2021 should help to support a strong recovery in real assets, unlike the 2010s.

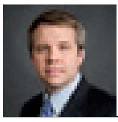
> *Price pressures in the U.S. are also likely to receive a modest fillip from a weaker currency.*

4 Stronger US dollar

Price pressures in the U.S. are also likely to receive a modest fillip from a weaker currency. There are longer-term pressures for the USD to decline, owing to narrowing growth and interest rate differentials, high U.S. fiscal and current account deficits, and ample USD liquidity. However, if the US dollar appreciates on the back of a roaring economy, inflation might be tempered.

CHINA'S ECONOMY: RECOVERY AND REBALANCING

Emerging from the pandemic, an encouraging pathway for China's economy.



Chris Kushlis, CFA
Asia Sovereign Credit Analyst

- China's V-shaped recovery from the coronavirus pandemic has been stark in comparison with many other economies.
- While this is encouraging, China's long-term strategy and track record are more important indicators as it strives to become a more developed economy.
- The rise of technology and innovation represents a meaningful shift in direction for China, a fact that is probably underappreciated by the market.

China and its strong economic recovery from the coronavirus pandemic have not gone unnoticed. Fourth-quarter gross domestic product (GDP) growth came in at 6.5% year over year, pushing the annual average growth to 2.3% for 2020. China should be the only major economy to record economic growth for 2020. But what lies ahead for the second-largest economy in the world, and what are the factors that we should watch for as it continues to progress?

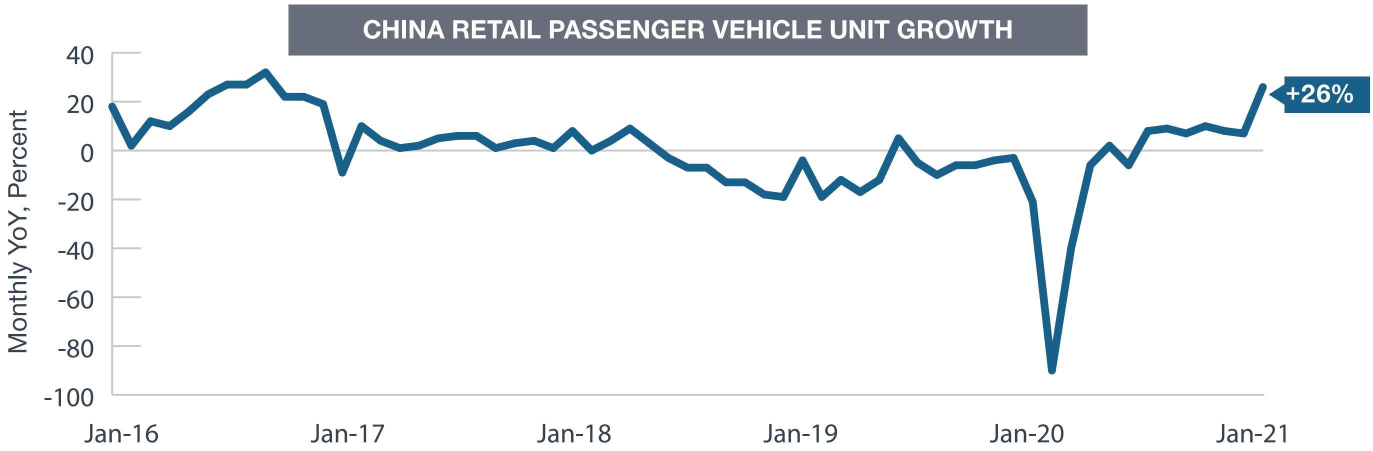
Pandemic Response Has Allowed a Much Quicker Recovery

China's V-shaped recovery has been primarily attributed to a strong public health response. China successfully implemented what the IMF called "effective containment measures" to aggressively curb the spread of COVID-19, the disease caused by the coronavirus. The return to a more normal environment has been driven by three main factors—swift lockdowns, testing, and masks.

China adopted stringent measures very quickly to deal with the pandemic, with previous experience of pandemics (e.g., SARS) and the political structure allowing for quicker control of the disease. This has allowed the economy to get back on track much quicker, with manufacturing the first to bounce back followed by a recovery in the services sector. Vehicle sales data provide one indicator of the nature of the V-shaped recovery.

FIGURE 1: China's V-Shaped Recovery

Chinese vehicle sales indicate a strong rebound in consumer spending and sentiment



As of January 31, 2021.
Source: China Association of Automobile Manufacturers.

China's Central Bank Is Playing the Long Game

The sharp recovery has not, however, been driven by major monetary or fiscal support. Unlike the unprecedented action taken by western central banks, China's policy response to the pandemic has been more muted. This is primarily because its rapid recovery has enabled policy to taper relatively quickly.

Compared with the stimulus measures undertaken in 2009 and 2016, Chinese policymakers have been a lot more guarded because of less balance sheet space but also because of not wishing to leave a legacy of higher debt. While credit to GDP jumped by over 20% in 2020, central bank policy for 2021 is focused on the ratio not going higher.

The People's Bank of China (PBoC) has initiated a number of policies, designed to prop up the economy in response to the coronavirus outbreak. But it has also been very careful at the same time not to increase the financial leverage in the system with the country's growing debt burden. It has succeeded in stalling the pace of growth in leverage, but there is still more to do, and the PBoC is likely to tread carefully. What is important to remember is that the PBoC has many weapons in its arsenal to help manage and ensure the stability of the economy. China has a strong record of achieving its objectives, and investors should remain focused on this.

> *...we expect economic growth to bounce back to around 8% to 9%, but after that, we expect it to head back down to around previous levels of 6%, with the medium-term growth rate being around 5%.*

Strong Recovery Followed by Managed Slowdown

In the short term, we expect economic growth to bounce back to around 8% to 9%, but after that, we expect it to head back down to around previous levels of 6%, with the medium-term growth rate being around 5%. Beyond that, we see a further moderation to around 4% to 5% levels. China has already indicated that it would like to become a more developed economy by 2035, and so an economic growth rate below 5% would correspond.

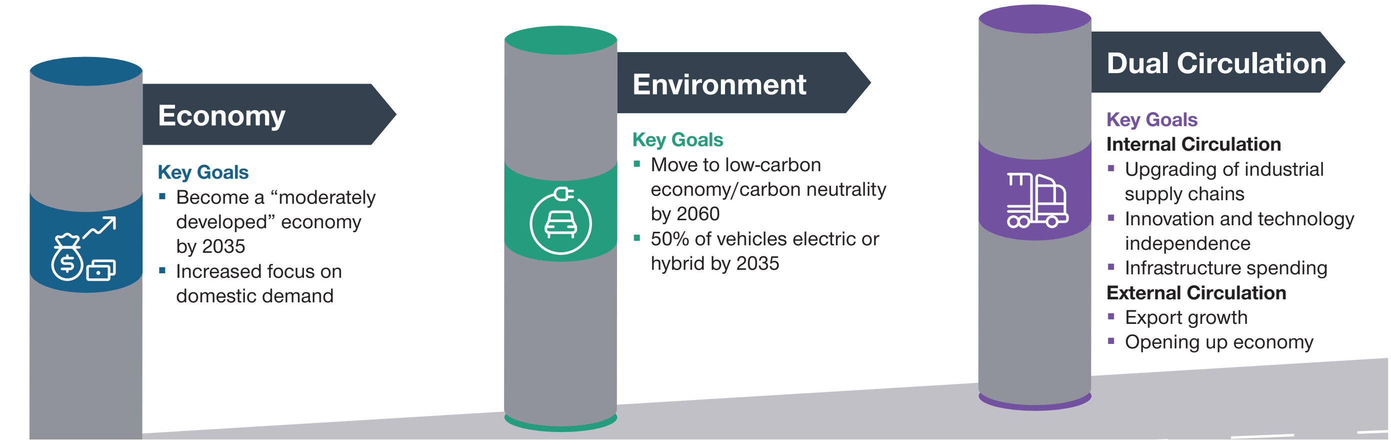
Driving that slowdown is the simple fact that China's working age population has started to shrink, and it is increasingly more difficult to eke out further productivity and technology gains. China has also been prioritizing the rebalancing of its economy for some time, looking to better reflect the three core pillars of growth—exports, fixed asset investment, and consumption.

Until 2008, exports dominated in terms of economic growth, while 2009 saw a sharp increase in fixed-asset investment to tackle the problems that the global financial crisis brought. Since then, policymakers have been actively targeting domestic drivers for economic growth. And there are encouraging signs of success, as export dependence has fallen in recent years. But with the services sector still only constituting around 60% of GDP, there is still some way to go to match developed economies.

Shifting Priorities With a Focus on Innovation

China remains the major manufacturing hub of the world, but the composition of what it manufactures is shifting from pumping out cheap products for the western world to consume to higher value-added

FIGURE 2: China's Economic Road Map
The 14th five-year plan (2021–2025)—three key goals



For illustrative purposes only.

items. Rising labor costs and the employment of artificial intelligence (AI) and robotics across swathes of industry have triggered a major change in the economy's direction—nudged by trade wars with the U.S. and other countries like Australia.

We have seen significant investment in research and development (R&D) for the last few years. Today, China is leading the way in many up-and-coming technologies, spanning artificial intelligence and digital currencies to mobile banking, health care, robotics, and 5G technology. We expect that Chinese companies will narrow the AI gap with their U.S. counterparts quite significantly in the next few years. This is supported by abundant engineering talent, deep pools of private sector investment, and large amounts of digital data for deploying machine-learning techniques. Companies also have government support in terms of regulation and research funding.

The rise of technology and innovation represents a meaningful shift in direction for China's economy...

The rise of technology and innovation represents a meaningful shift in direction for China's economy that is probably underappreciated by the market. Some believe that China is just mimicking U.S. companies, with Alibaba and Tencent as the eBay and Facebook of China. However, we believe this does not reflect the reality, with these companies leading the way in many fields. The top-down drive to push innovation will continue, and we may see some failures along the way, but the direction of travel is clear.

China's Economic Road Map

China is often accused of a lack of transparency, but when it comes to the economy, it is a different story. Since 1953, China has published a five-year plan that details economic development goals for the next five years. The 14th Five-Year Plan (2021–2025) was drafted during the fifth plenum held in October

FIGURE 3: Long-Term Drivers for China's Economy

Urbanization	Infrastructure	Rising Middle Class (Consumer Power)
▪ China has become the world's largest urban nation with over 843 million urban citizens as of the end of 2019,[1] a figure that is projected to grow further.	▪ From roads and rail to subway systems, water, pipes, waste treatment, and pollution controls to ports and airports, the demand for infrastructure is much needed.	▪ China's middle class has grown from around 65 million in January 2005 to over 700 million in 2020.
▪ Every year, only about 10 million people leave the countryside, but another 10 million are absorbed by the simple process of expanding the city boundaries.	▪ Infrastructure is a key part of China's "dual circulation" program.	

As of March 2021.
[1] Source: World Bank.

2020 and will be finalized at the National People's Congress in March 2021. Guidelines for the plan focused on President Xi Jinping's "dual circulation" theory, sustaining higher-quality growth through encouraging domestic markets, innovation, and reform.

Beijing views boosting domestic demand, upgrading supply chains, and seeking self-sufficiency in key technologies as ways to hedge against external uncertainties and challenges. Dual circulation also supports the need for greater reliance on homegrown technology, and we expect a trend toward greater spending on R&D within capex budgets in the coming years.

> *...policymakers continuing to seek lower, more sustainable growth, but of better quality.*

Challenges Ahead, but Rising Consumerism Should Help Drive the Economy in a Different Direction

It is no secret that China faces a number of headwinds, including slowing growth, a high debt-to-GDP ratio, an aging population, U.S. trade war tariffs that are still in place, and lower potential growth as resources shift into lower-productivity services. We may also see exports suffer from improved work resumption in other economies as the pandemic is gradually controlled.

But the long-term drivers remain. Urbanization, infrastructure, and a rising middle class provide pillars for future growth. There also may be a misconception that urbanization is largely about people moving from rural China to towns and cities. Instead, we believe its main feature is the upgrading of living space and amenities.

Some commentators perceive, incorrectly, that urbanization is purely about expanding numbers. We see it as expanding spending, as existing urban households upgrade from dilapidated state apartments to modern and often much larger apartments or houses.

The rise of the middle class should also help power China in a different direction. That comes with a rise in disposable income with household income having grown at around 10% annually. This increased income will likely engender greater spending and subsequently help drive the domestic element of economic growth upward.

Alongside household consumption, fixed-asset investment will also remain a major theme. The large growth in urban housing space and vehicle population will need infrastructure. At the same time, China is finding answers to its aging population problem in pharmaceutical developments, with this industry already the second largest globally, fueled by government initiatives.

Focus on China's Successful Record

Policies in China over the next few years will continue to focus on structural reforms, with policymakers continuing to seek lower, more sustainable growth, but of better quality. This is the long-term goal, and investors should concentrate on China's past record and its ability to achieve this. ■

WHAT WE'RE WATCHING NEXT

We shall continue to monitor macro data to ensure that the recovery continues. The data so far this year are encouraging. We are hearing of rising wages and greater employment. Data showed urban job creation reached 11.9 million in 2020 (versus a target of 9 million), while the official unemployment rate has continued to trend down throughout the fourth quarter to 5.2% in December.

Looking ahead, softening property and infrastructure investment may weigh on construction hiring, while service hiring should recover further as activities rebound. In the near term, we think the recent mobility restrictions and travel constraints during Chinese New Year may bring some downward pressures for domestic consumption, but we expect that to be temporary. After the first quarter, with COVID-19 cases under control and the labor market improving, we expect consumption—in particular, service consumption—to recover further on stronger consumer income and confidence.

*This is part of a series of **TRP Insights** focusing on **China**. The aim in our series **Investing in China** is to explore the key drivers for China's economy, market opportunity, outlook, and our strategy for investing.*

The specific securities identified and described are for informational purposes only and do not represent recommendations.

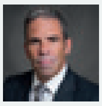
WHY ESG FACTORS MATTER IN ASIA CREDIT INVESTING

Integrating ESG factors can help manage downside risk and identify high-quality businesses driving positive change.

- ESG investing is on the rise in Asia, where regional governments have stepped up disclosure requirements amid a drive towards sustainability.
- We believe that ESG integration can help identify high-quality, forward-thinking businesses for investment and manage downside risks in credit portfolios
- For an investment to earn a position in our Asia Credit Bond Strategy, it should satisfy a three-step process with ESG analysis embedded at every stage.

Sheldon Chan
Portfolio Manager
Asia Credit Bond Strategy

Emerging Markets Debt Leadership Team



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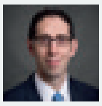

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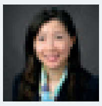
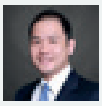


Carolyn Chu



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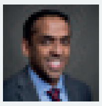

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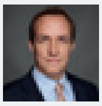


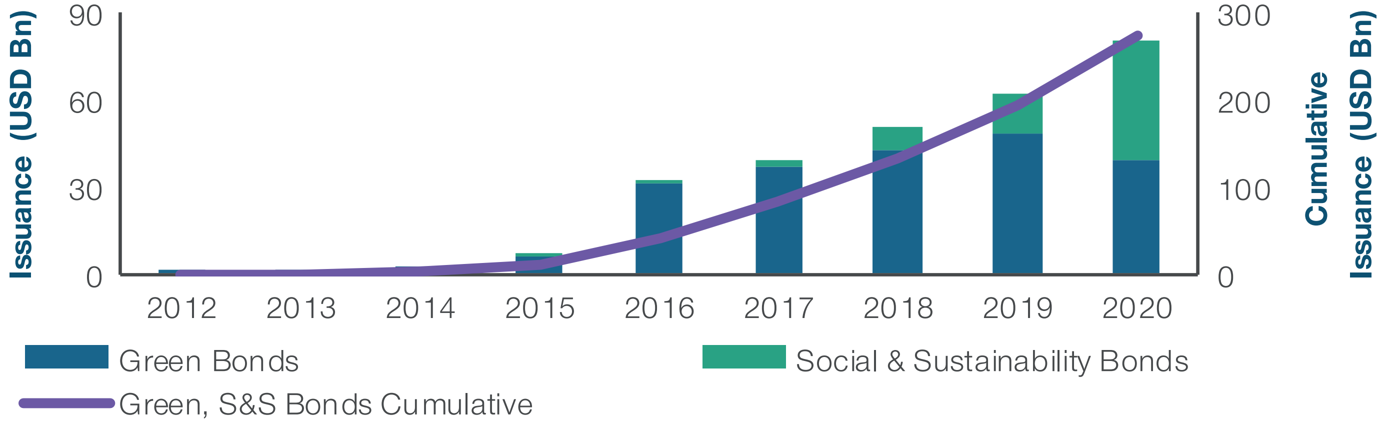
Andrew Keirle

Already mainstream in Europe, responsible investing is fast becoming a key consideration in Asia as well. The integration of environmental, social and governance (ESG) factors into investment decisions has gained recognition as an important method of downside risk management and a driver of risk-adjusted returns. Looking specifically at credit investing, 60% of regional investors expect governance issues will impact corporate bond yields in 2022, while more than two out of five expect environmental and social factors will matter.[1]

The ESG landscape in Asia should continue to evolve since it is still at an early development stage. We also expect that there may be a divergence in terms of which countries make the most strides in promoting ESG awareness and implementing reporting requirements based on their unique characteristics.

[1] CFA Institute. *ESG Integration in Asia Pacific: Markets, Practices and Data.* 2019.

FIGURE 1: ESG Investing on the Rise in Asia
Growth in Asian sustainable issuance



As at December 31, 2020.
Source: BNP Paribas and Bloomberg Finance L.P. Data analysis by T. Rowe Price. Sustainable issuance isned as the combined total of green bond and social & sustainability bond issuances.

A growing push for responsible investing from across the stakeholder spectrum suggests that it is here to stay. Adapting an approach for Asia requires careful monitoring of the latest developments within the region along with a robust ESG research platform. We believe strategic investors who are able to do that should find themselves well positioned to drive positive change and capitalize on potential opportunities presented by the evolving ESG landscape.

> *The cumulative value of sustainable issuance in Asia surged sevenfold in just four years to US $275 billion in 2020.*

ESG Investing in Asia

Although Asia has been a relative laggard in adopting ESG integration or applying sustainable objectives to their investment mandates, this region has been at the forefront of socially responsible investing (incorporating values into their investment mandates) with regards to Islamic finance. Malaysia established a law in 1983 to regulate banking compliant with Islamic tradition and topped the Global Islamic Economy Indicator rankings for an eighth straight year. Indonesia, which has the world's largest Islamic population, ranked fourth behind Saudi Arabia and the United Arab Emirates.[2]

More recently, investing with sustainable objectives has also gained a foothold in the region. The cumulative value of sustainable issuance in Asia surged sevenfold in just four years to US $275 billion in 2020 (See Fig. 1). China and South Korea combined to account for two-thirds of the total with the rest split between Hong Kong and countries like Japan, India and the Philippines.

The growth in sustainable issuance has come as government regulations have expanded the depth and breadth of comparative ESG data. For instance, ESG disclosure requirements are now mandatory for publicly listed companies in Hong Kong, Singapore, Thailand and the Philippines. In China, listed companies already face certain reporting requirements, while the China Securities Regulatory Commission is expected to announce mandatory ESG disclosure guidelines later this year. Elsewhere, India and South Korea have updated voluntary recommendations to enhance ESG reporting.

Further ESG disclosure requirements are also likely to arise out of the growing push underway in most countries across the region to shrink their carbon footprints and curb the usage of fossil fuels for power generation. China, for example, has redoubled its environmental focus and has committed to having its carbon dioxide emissions peak before 2030, and becoming carbon neutral before 2060. We also expect that another tailwind for ESG investing will come from asset owners themselves who feel that investments should not only deliver strong performance potential but also drive positive change.

[2] DinarStandard. *State of the Global Islamic Economy Report 2020/21.* 2021.

ESG Challenges and Opportunities in Asia Credit

We anticipate that sustainable issuance will continue to increase rapidly in Asia as ESG investing becomes an increasingly important priority for asset managers and owners alike. There are still plenty of growing pains to push through, however, creating an opportunity for strategic investors to capitalize on any price dislocations.

Asian issuers have tended to screen poorly in terms of ESG disclosure, making it difficult to form a comprehensive picture of their potential liabilities and the steps that they might take to overcome them. Investors could potentially overcome this challenge through increased engagement. In a similar vein, bondholders who are able to collaborate jointly across the asset classes should be able to improve their access to corporate management and possibly gain more influence when discussing ESG factors.

Going forward, we also expect that Asia's increasing push toward sustainability and reducing the reliance on fossil fuels could provide a structural tailwind for higher sustainable issuance. Currently, the investment universe is skewed towards capital- and commodity-intensive industries, while the technology and consumer sectors make up a far smaller weighting when compared with the regional equity market where they represent more than a combined third of the benchmark. In our view, this is likely to change and creates an opportunity for investors to capitalize on a broader opportunity set through fundamental, bottom-up research.

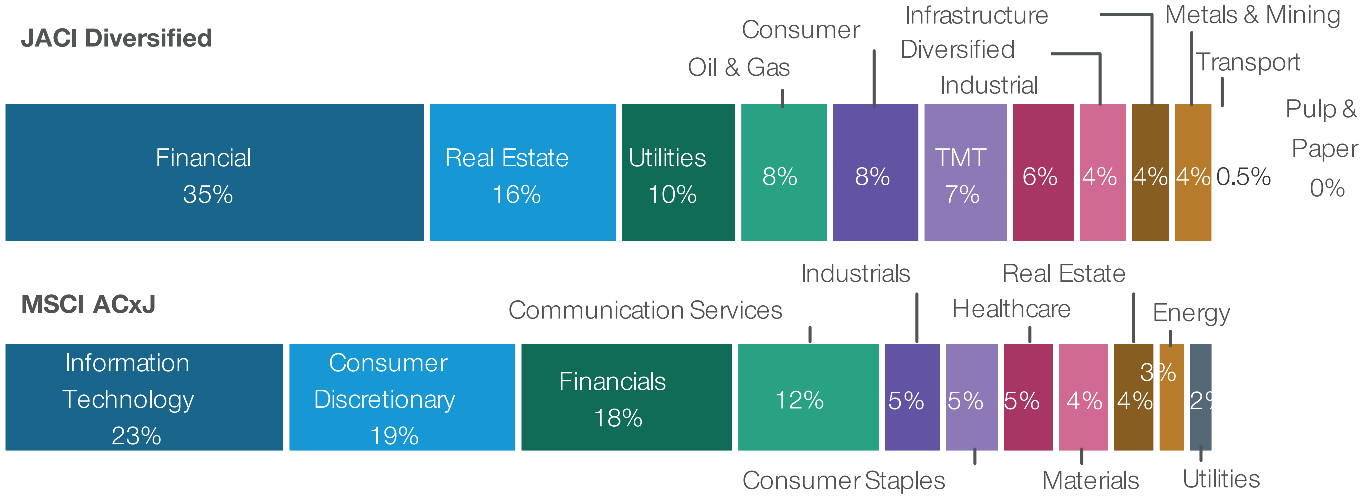
We believe that integrating ESG considerations into a fundamental, bottom-up research process can help to identify high-quality, forward-thinking companies.

Considering ESG Factors Can Help to Manage Downside

We believe that incorporating ESG factors into our investment process alongside financial, valuation, macroeconomic, and other fundamental factors, is consistent with our central mission of helping clients reach their long-term financial goals. Our philosophy is that ESG factors are another key component or input into the decision-making process – meaning they are not the sole driver of an investment decision, nor are they considered separately from more traditional analysis.

In terms of the Asia credit asset class, we believe that integrating ESG considerations into a fundamental, bottom-up research process can help to identify high-quality, forward-thinking companies – businesses with greater prospects for long-term sustainability and, in turn, potential for improved credit risk profiles. Importantly, we believe this ESG integration could also potentially provide some downside risk management to portfolio performance. In practice, an ESG-version of the J.P. Morgan Asia Credit Index (JESG JACI), which is a USD-only benchmark covering Asia ex-Japan, showed positive convexity,

FIGURE 2: Concentrated Investment Opportunity Set in Asia Credit
Benchmark sector weightings



Numbers may not add to 100% due to rounding.
As of February 28, 2021.
Source: MSCI, JP. Morgan, Bloomberg; Analysis by T. Rowe Price.
Indices: JACI Diversified – J.P. Morgan Asia Credit Index Diversified; MSCI ACxJ – MSCI All Country Asia ex-Japan Index

with greater beta in weeks of positive spread return (0.980) than in negative weeks (0.955).[3]

Indeed, JESG JACI managed to outperform the broader JACI benchmark on multiple occasions over the past decade during downturn periods. Although it did not outperform in every instance, the positive track record signals that considering ESG factors could potentially help mitigate downside risk. The maximum drawdown in JESG JACI was less, for instance, during the global market rout in March 2020 that was triggered by the onset of the COVID-19 pandemic.

Asia Credit Bond Strategy Utilizes a Fully Integrated ESG Approach

For an investment to earn a position in the Asia Credit Bond Strategy it should satisfy the following three steps: (1) fundamental analysis (2) issuer engagement and (3) portfolio construction. Importantly, ESG analysis is embedded throughout this process.

Fundamental Analysis: We believe the best investment decisions are made when multiple perspectives are considered in the research process. Credit analysts collaborate with Responsible Investing (RI) analysts to incorporate ESG considerations into both qualitative and quantitative credit analysis. We utilize the Responsible Investing Indicator Model (RIIM), our proprietary tool developed by our ESG specialists to help screen our investment universe for responsible investing risks and opportunities. RIIM is currently able to analyze the RI profile of approximately 15,000 companies.

Issuer Engagement: Credit analysts routinely maintain dialogue with issuer management teams to stay on top of evolving investment theses and to identify potential risks, their materiality, their probability and mitigants. These will often be conducted alongside RI analysts and other interested parties (i.e., equity analysts, sector specialists, portfolio managers) to optimize the quality of information gathered. As it relates to ESG, we aim to be agents of change and want to support proactive issuers that show an approach to minimize potential liabilities from ESG risks.

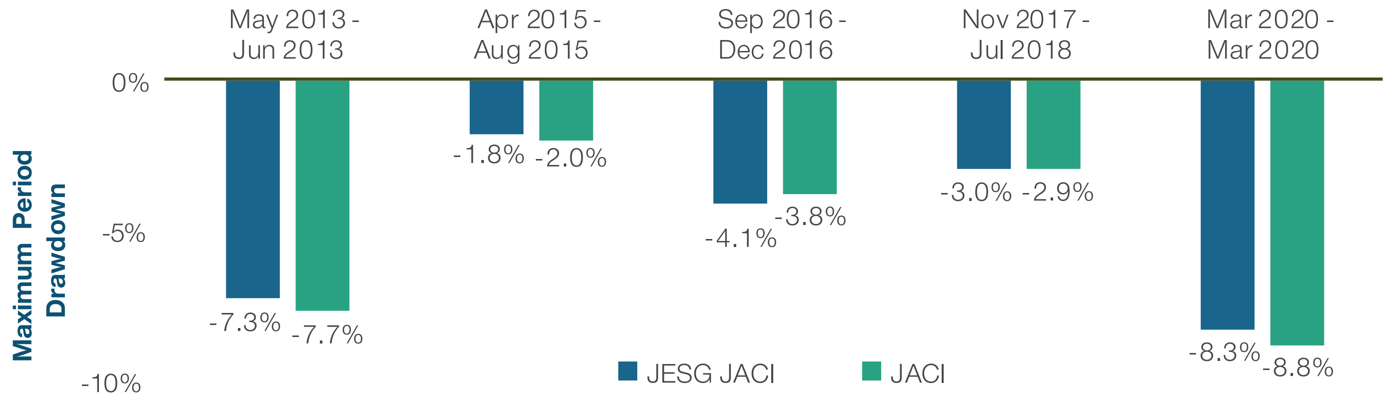
Portfolio Construction: The Asia Credit Bond Strategy follows a transparent and consistent process to size positions. The process is underpinned by several inputs, such as analyst conviction scores, credit ratings, and the assessment of ESG considerations. The portfolio manager balances factor exposures at the portfolio level, including ESG risks. Given the asymmetry in bond returns, the main focus is to limit exposure to issuers that may be subjected to headline risk.

ESG Integration In Action

The consideration of ESG factors has been a direct influence in helping us to identify certain high-quality companies that we believe can offer attractive risk-return potential.

For instance, we invested in a Philippine utility company, which manages a growing portfolio of renewable assets and which has set ambitious targets for further deployment of solar, wind, and geothermal capacity, while selling down stakes in its legacy thermal business. In our opinion, the company

FIGURE 3: ESG Index Outperformed During Sell-offs
Maximum period drawdown during downturn periods



Past Past performance is not a reliable indicator of future performance.
As of February 28, 2021.
Source: T. Rowe Price, based on data from J.P. Morgan.
Indices: JESG JACI – J.P. Morgan ESG Asia Credit Index; JACI - J.P. Morgan Asia Credit Index

[3] Source: J.P. Morgan; analysis period is January 2013-February 2021.

presented an attractive investment opportunity given its forward-thinking approach and comprehensive level of disclosure, alongside fundamental considerations, including improved leverage and a strong track record with investors.

Elsewhere, we also invested in a nutrition products provider in China, which is a market leader in its field. The company's management have demonstrated a clear commitment to reducing carbon emissions and also improving employee wellbeing. Our investment case was supported by the company's clear sustainability strategy, as well as its consistent track record of stable growth and positive free cash flow.

WHAT WE'RE WATCHING NEXT

While ESG is fast becoming mainstream in Asia, we expect that there will be an inevitable divergence within the region in terms of which countries make the most strides in promoting ESG awareness and increasing company disclosure requirements. This only reaffirms the importance of a robust, dedicated ESG research platform that can keep pace with new developments.

The nature of ESG investing is also likely to evolve as future issues cast current ESG factors in a new light. We believe maintaining a regular dialogue with the management teams of companies represented in our portfolios is the best way of staying ahead of any changes that may affect their businesses.

Key Risks –The following risks are materially relevant to the strategy highlighted in this material:
Transactions in securities denominated in foreign currencies are subject to fluctuations in exchange rates which may affect the value of an investment. Returns can be more volatile than other, more developed, markets due to changes in market, political and economic conditions. Debt securities could suffer an adverse change in financial condition due to ratings downgrade or default which may affect the value of an investment.

MEET KAI YOICHIRO

An Interview with Kai Yoichiro, Portfolio Manager, Global Dividend Equity Strategy

Kai Yoichiro
Portfolio Manager, Global Dividend Equity Strategy

BIOGRAPHY

Career

Yoichiro has 22 years of investment experience, 12 of which have been with T. Rowe Price.

1998 – 2000
Joined Goldman Sachs Asset Management as a financial analyst after three years in manufacturing industry.

2001 – 2007
Spent six years as an equity analyst with Fidelity in Tokyo.

2007 – 2008
Joined international hedge fund Citadel Investment Group.

2009 – 2017
Joined T. Rowe Price as an analyst covering Japanese financial stocks, later moving to Singapore to cover regional financials.

2017 – present
Portfolio manager, T. Rowe Price Global Dividend Equity Strategy.

Professional & Education

Yoichiro has a BA degree in Policy Management from KEIO University. He holds the Chartered Financial Analyst (CFA) designation of Japan.

What first attracted you to a career in asset management? How did you come to join the T. Rowe Price family?

After university I joined a heavy industry manufacturer, moving to banking three years later. Several of my college friends had become security analysts and every time we got together, I found their conversations about stocks and markets really interesting. I was already studying for the CFA exam and decided to switch from banking to investment management. By my mid-twenties, I had joined Goldman Sachs Asset Management where I worked for three years learning the ropes, followed by a six year stint at Fidelity. At the time of the Global Financial Crisis I had been working for two years in Tokyo at a hedge fund, Citadel Investment Group. In December 2008, not long after the Lehman bankruptcy, Citadel announced it was pulling out of Asia, and closed its Tokyo office immediately, with a loss of 90 employees. I learnt firsthand about the more 'brutal' side of working in finance when I was given a cardboard box, told to pack up my personal things and leave the office by midday!

Fortunately, thanks to my wife I was already talking to T. Rowe Price at the time about a potential job move. My wife was interviewing for a position at the firm, and somebody told T. Rowe Price I might also be a suitable candidate for the position. So I found my wife and I were competing for the same job! What followed is history, and I have spent twelve happy years with my extended family at T. Rowe Price. So I was a late starter, almost 36, when I joined the firm as an analyst covering Japanese financial stocks, moving to Singapore nine years ago to cover Asian regional financial stocks. Four years ago I applied for the role of PM for the T. Rowe Price Global Dividend Equity Strategy. This was the first time that the firm chose somebody in Asia for a broad, global mandate. Of course, with video conferencing it has become a lot easier to be a global PM based in Tokyo, as long as you can handle the big time difference!

Can you tell us about the Global Equity Dividend Strategy that you manage? What kind of investor is the strategy suitable for?

Our aim is to showcase the best global equity income ideas of T. Rowe Price analysts. So the strategy is suitable for those investors who want a regular income stream in the form of dividends from a portfolio of global equities. When dividends are reinvested, it is also suitable for investors who are looking to accumulate wealth. One important point I want to make is that a global equity dividend strategy is really quite different from a growth or a value strategy. There is a surprisingly low overlap with the growth or value in terms of opportunity sets.

I think investors are currently looking for a dividend yield (DY) that is above the 10-year U.S. Treasury bond yield and in principle over the

FIGURE 1: Relaxing with Junior at the weekend - Tokyo skyline in the background

longer run should be hedged against inflation. The combination of yield and inflation hedge is a key feature of a global equity income strategy.

The majority of total global equity returns historically have come from reinvested dividends. Not many investors seem to be aware of this, but since 1970 around 70% of total equity returns for the MSCI World index have come from reinvested dividends. In stock selection, I look for companies with both good cash flow and a good dividend track record over time. This combination makes the strategy suitable for investors who are looking for less volatility in quarterly returns than they might receive from a standard global equity fund.

T. Rowe Price has a strong global research platform, with over 200 analysts. How do you employ this valuable resource to discover companies that can offer both an attractive yield and good growth opportunities?

The answer is close collaboration and teamwork, as this is by far the biggest influence on portfolio performance. It is also where many firms stumble since in practice it is easier said than done. T. Rowe Price's senior analysts, sector and country experts are all highly experienced, with a great depth of professional knowledge. Other global asset managers with our scale in terms of AUM (assets under management) often employ 400 to 500 analysts. That is simply too many for one global portfolio manager like myself to get to know (and trust). T. Rowe Price is actually a lean firm (with 200 analysts) where I can get to know all of the senior analysts and portfolio managers personally. Before the coronavirus pandemic I would spend around half of each month travelling between regional offices, spending a lot of time during my visits in company meetings with T. Rowe Price analysts.

Now, thanks to online video communications I can remain in Tokyo yet attend more company meetings than before without the stress and strain of constant travel, such as worrying about catching a connecting flight in the early hours. So I think that working from home in the post pandemic era is going to enable global portfolio managers like myself to work more efficiently. I can, for example, connect from Tokyo to webinar conferences in New York and London on the same day, with more time for reflection, and still get a good night's sleep!

Some expect bond yields to rise further this year under a strong global recovery scenario. How vulnerable might dividend stocks be to a move higher in sovereign yields?

I agree that global long-term rates may rise further, as a strong recovery appears likely. The important thing is to know how to best manage the strategy over rate steepening and flattening cycles. Traditional high DY stocks or 'bond substitutes' such as utilities, REITs, infrastructure, or telecom companies would likely prove vulnerable if U.S. Treasury yields rise faster than the markets currently expect. However, I believe there are also cyclical growth dividend payers among banks, insurance, chemicals, commodity, or property stocks that can outperform in upcycles even as bond yields rise. Dividend stocks can also be found in the technology sector among semiconductor manufacturers and semiconductor equipment companies.

A key to reducing the interest rate sensitivity of the portfolio is to maintain a good balance between these two types of dividend stocks over the interest rate cycle. This lies at the heart of a dividend income strategy. As the economic cycle weakens and the yield curve flattens, I think one should have more stocks in the traditional high DY bucket. Conversely, one should have more cyclical growth dividend stocks during the economic recovery phase, when yield curves are steepening. Thus we tend to follow a dynamic barbell approach in which our weighted average DY stays much the same, but where the portfolios' interest rate beta or sensitivity varies over the cycle.

With global growth estimates being upgraded after the vaccination rollout and Biden fiscal package, the prospects for a strong rebound in earnings later this year look good. Where are we in terms of the dividend cycle?

The short but deep 2020 global recession caused by the pandemic had a very big impact on dividend payouts. Over 30% of MSCI World companies were forced to cut their dividends. We did a relatively good job at avoiding dividend cutters, with only around 16% of holdings doing so in the downgrade cycles last year in Q2 and Q3. Some companies were able to grow their dividends even during the pandemic. Often these were more mature, asset-heavy businesses that were vulnerable to lockdowns given their negative operating leverage when demand dried up. Others, such as banks in a number of countries including the UK, Europe and Singapore, were obliged by government measures to cut or refrain from paying dividends even though they had the ability to pay.

There are also companies with strong balance sheets and management in areas like consumer discretionary, transport, infrastructure, and entertainment that although hit by the pandemic are showing the ability to stage strong recoveries. Companies to avoid are dividend cutters which already had issues and fragilities before the pandemic struck.

In stock selection, how do you balance the objectives of a high initial dividend yield with the ability to generate strong cash flow and grow dividends over time?

As mentioned above, we take a barbell approach, seeking a combination of less growthy high yield dividend stocks and stocks with higher cash flow growth but lower DY. The skill is to blend stocks from these two buckets to identify a portfolio that has both an attractive yield and good growth opportunities over the cycle. In terms of key metrics, the result tends to be a portfolio with quite a high PE ratio, EV to EBITDA and RoE. This is different from either a value or a growth strategy, tending to sit more in the middle although when you own high-quality dividend paying stocks you tend to own relatively expensive stocks.

Global equity dividend strategies tend to have a low stock overlap with global growth strategies, and a higher overlap with core international equity, though this may still be less than 20%. Stock overlap tends to be higher with Asia ex-Japan and emerging market strategies. Across all T. Rowe Price equity strategies combined there is a high overlap in stock selection, an indication that we are indeed picking many of the best income ideas from T. Rowe Price equity analysts.

When you are not focusing on work, what occupies your spare time?

I could say reading e-books (fantasy fiction to help me escape from work for a short time!), watching movies, going to the gym. Quite a long list of activities. However, my three-year old son takes up most of his Dad's time at weekends! I wouldn't have it any other way.

ABOUT US

T. Rowe Price is a global independent investment management firm. We are solely focused on long-term results for our clients, managing a full range of investment strategies in multiple asset classes. For over 80 years, our consistent investment approach has helped us focus on promising opportunities while at the same time carefully managing risk.

We established our Tokyo office and Hong Kong office in 1982 and 1987 respectively, and since then we have expanded our business by operating in Australia and Singapore. Today we have more than 200 associates based locally.

INDEPENDENT ASSET MANAGER
Our sole business is managing our clients' interests

ALIGNMENT OF INTERESTS
We are a publicly listed company with substantial employee ownership

FINANCIAL STRENGTH
We carry no outstanding long-term debt and maintain substantial cash reserves

GLOBAL EXPERTISE
Continually growing global team of investment professionals

Founded in
Baltimore, USA in 1937

USD1.52
trillion in assets under management[1, 2]

745
investment professionals worldwide[3]

Local presence in
16
countries[3]

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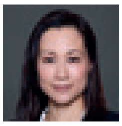
To learn more about our capabilities, please contact us directly:



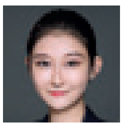
ELSIE CHAN
Head of Distribution
Asia ex Japan
+852 2536 7320
elsie.chan@troweprice.com

DEREK YUEN
Relationship Management Associate
Hong Kong and Taiwan
+852 2536 7839
derek.yuen@troweprice.com

DA SEUL LEE
Relationship Management
Korea
+65 6395 4166
da.seul.lee@troweprice.com

LEAH LAM
Relationship Management Associate
South East Asia
+65 6395 4179
leah.lam@troweprice.com

LAMBERT XU
Relationship Management
China
+852 2536 7322
lambert.xu@troweprice.com



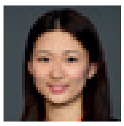
GLORIA ZHENG
Relationship Management
China
+852 2536 8986
gloria.zheng@troweprice.com

GEORGE CHOW
Relationship Management
Hong Kong and Taiwan
+852 2536 7302
george.chow@troweprice.com

SAE JOON CHOI
Relationship Management
Korea
+65 6395 4159
sae.joon.choi@troweprice.com

ANDERSON QUAH
Relationship Management
South East Asia
+65 6395 4161
anderson.quah@troweprice.com

PHILIP LIN
Relationship Management
Head of China
+852 2536 8925
philip.lin@troweprice.com



SARAH DONG
Relationship Management
China
+852 2536 8913
sarah.dong@troweprice.com

[1] Firmwide AUM includes assets managed by T. Rowe Price Associates, Inc. and its investment advisory affiliates.
[2] As at March 31 2021. Preliminary data. Subject to adjustment.
[3] As at March 31 2021.

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