

THEME TWO

Fundamentals Matter

A brutal spike in bond yields largely drove global equity losses in the first half of the year. In the second half, stock market performance is likely to depend on the outlook for corporate earnings growth.

After spending most of 2021 in deep negative territory, Page notes, the real, or after-inflation, 10-year Treasury yield (as measured by the 10-year TIPS yield) turned positive at the end of April. Figure 3 (left panel) shows the effect this had on U.S. equity valuations, which fell closer toward the middle of their recent historical range.

Now, Page says, with growth concerns rising, the focus is shifting to the “E” side of the price/earnings (P/E) ratio. “Everybody’s wondering if this will be the next shoe to drop.”

Although earnings momentum sagged in many non-U.S. markets in the first half, earnings per share (EPS) growth in the U.S. remained surprisingly steady (Figure 3, right panel). But Page says he doesn’t believe this strength will last. “I think U.S. earnings are likely to decelerate in the second half, challenged by slowing economic growth,” he predicts.

Supply chain improvements also could impact earnings—but maybe not in a good way, Page says. While moving more products might boost sales and revenues, it also could limit pricing power and eat into profit margins.

Sector and Style Leadership

Poor earnings environments historically have tended to favor the growth style, which typically is less threatened by cyclical downturns. But, Thomson says, this time could be different, given the heavy weight the technology sector now carries in the growth universe.

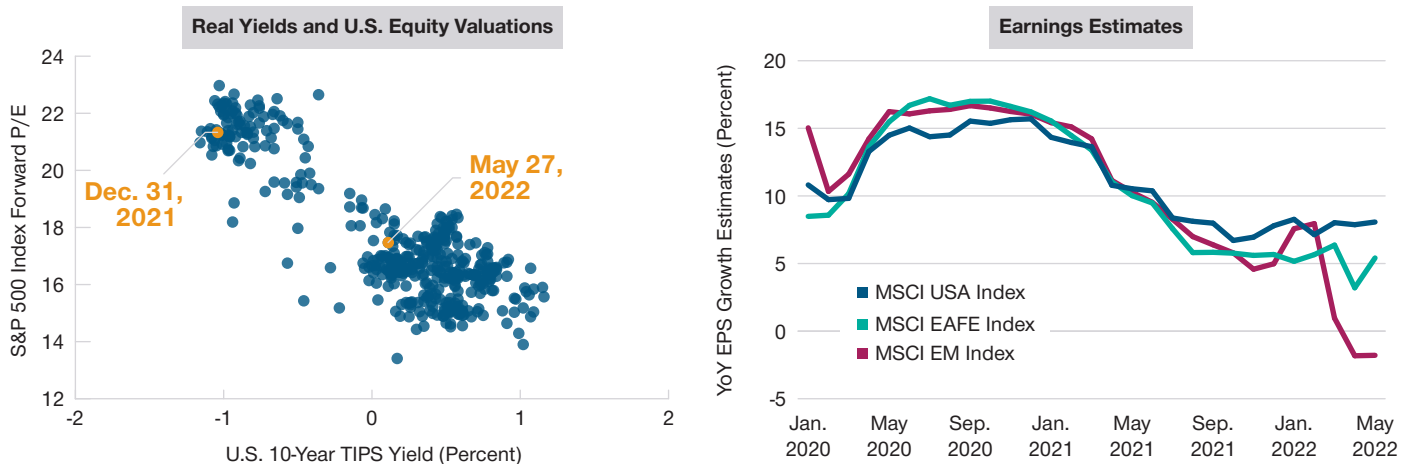
“The pandemic really did pull forward digitization, so we’re going to be lapping some very strong 2021 earnings comparisons in the second half,” Thomson explains. “We’re also seeing some late-cycle effects that are detrimental to tech, such as skill shortages and salary inflation.”

Consumer-oriented technology platforms, such as streaming media, also could be exposed to a cyclical slowdown in spending, he adds.

These factors suggest that the back-and-forth style rotations seen since

The Balance of Equity Risks Is Shifting From Interest Rates to Earnings Growth

(Fig. 3) S&P 500 Index forward P/E vs. 10-year Treasury real yield and 2022 EPS growth estimates in USD



P/E versus real yields from January 3, 2014, through May 27, 2022. EPS estimates from January 31, 2020, through May 31, 2022.

Sources: Haver Analytics/U.S. Bureau of Economic Analysis, Federal Reserve Bank of Dallas, MSCI, and T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved (see Additional Disclosures).

“A shift in market leadership appears to be underway. As we’ve seen from history, these cycles have tended to last a long time.

— Justin Thomson
 Head of International Equity
 and Chief Investment Officer

the pandemic recovery have tipped in favor of value. “A shift in market leadership appears to be underway,” Thomson says. “As we’ve seen from history, these cycles have tended to last a long time.”

China Could Offer Opportunities

With the Morgan Stanley Capital International (MSCI) China Index down almost 50% from its early 2021 peak as of the end of May, Chinese equity valuations appeared potentially attractive, Thomson suggests. However, Beijing’s “zero COVID” strategy has been a key obstacle to a growth revival.

“China has the capacity to stimulate,” Thomson observes. “But there’s no point in stimulating while locking down. It’s like stepping on the accelerator and the brake at the same time.”

How effectively Chinese policymakers will be able to boost growth in the second half is not yet clear, Thomson says. In addition to the coronavirus, sagging property values and credit defaults also could challenge any stimulus efforts.

That said, Thomson adds, in a world where many central banks are

withdrawing liquidity to fight inflation, and governments in many developed countries are running deep fiscal deficits, China at least has scope to focus policy on supporting growth.

Another key factor for Chinese equities in the second half could be the regulatory climate, Thomson says, including Beijing’s treatment of the country’s domestic technology platform companies and its crackdown on foreign depository receipt listings.

Thomson says he believes regulatory policies are likely to turn more market friendly in the runup to the Chinese Communist Party’s 20th Party Congress later in the year. “This regulatory cycle has been particularly drawn out and deep,” he says. “But we believe these issues will get better from here.”

Thomson says he’s reluctant to predict a leadership shift to non-U.S. equities in the second half, given the U.S. market’s extended outperformance over the past decade. However, if the U.S. dollar appreciation seen in the first half subsides, and the technology sector continues to struggle, the relative performance of non-U.S. equity markets should at least improve, he says.

FUNDAMENTALS MATTER		
Investment Idea	Rationale	Examples
Less-Rate-Sensitive Equities	Higher interest rates potentially could favor some value sectors, including financials. The growth style could be challenged by tough year-over-year earnings growth comparisons and continued weakness in the technology sector.	<ul style="list-style-type: none"> Value Stocks
Faster Growth in China and Other Emerging Markets	China is expected to use economic stimulus to speed its recovery from COVID-19 lockdowns. Reopenings and less restrictive regulatory policies could support Chinese equities and help boost growth in other emerging markets.	<ul style="list-style-type: none"> Chinese Equities Emerging Market Equities

For illustrative purposes only. This is not intended to be investment advice or a recommendation to take any particular investment action.

Additional Disclosures

MSCI and its affiliates and third party sources and providers (collectively, "MSCI") makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. Historical MSCI data and analysis should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such.

Copyright © 2022, S&P Global Market Intelligence (and its affiliates, as applicable). Reproduction of any information, data or material, including ratings ("Content") in any form is prohibited except with the prior written permission of the relevant party. Such party, its affiliates and suppliers ("Content Providers") do not guarantee the accuracy, adequacy, completeness, timeliness or availability of any Content and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such Content. In no event shall Content Providers be liable for any damages, costs, expenses, legal fees, or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. A reference to a particular investment or security, a rating or any observation concerning an investment that is part of the Content is not a recommendation to buy, sell or hold such investment or security, does not address the suitability of an investment or security and should not be relied on as investment advice. Credit ratings are statements of opinions and are not statements of fact.

Information has been obtained from sources believed to be reliable but J.P. Morgan does not warrant its completeness or accuracy. The index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval. Copyright © 2022, J.P. Morgan Chase & Co. All rights reserved.

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

T.RowePrice[®]

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.

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—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.

Mainland 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 mainland of the People's Republic of China ("Mainland China", not including the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the Mainland China. 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 Mainland China. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the Mainland China that are expressly authorized under the laws and regulations of the Mainland China to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the Mainland China. Potential investors who are resident in the Mainland China are responsible for obtaining the required approvals from all relevant government authorities in the Mainland China, 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 Mainland China, or nationals with permanent residence in the Mainland China, or to any corporation, partnership, or other entity incorporated or established in the Mainland China.

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. (UEN: 201021137E), 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), 60 Queen Victoria Street, London, EC4N 4TZ, is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (Financial Services Provider (FSP) Licence Number 31935), authorised to provide "intermediary services" to South African Investors. TRPIL's Complaint Handling Procedures are available to clients upon request. The Financial Advisory and Intermediary Services Act Ombud in South Africa deals with complaints from clients against FSPs in relation to the specific services rendered by FSPs. The contact details are noted below: Telephone: +27 12 762 5000, Web: www.faisombud.co.za, Email: info@faisombud.co.za

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.

© 2022 T. Rowe Price. All Rights Reserved. T. ROWE PRICE, INVEST WITH CONFIDENCE, and the Bighorn Sheep design are, collectively and/or apart, trademarks of T. Rowe Price Group, Inc.