T. Rowe Price®
INVEST WITH CONFIDENCE

2022 Midyear Market Outlook

Transitioning to a New Paradigm

Executive Summary

NAVIGATING CHALLENGING CURRENTS

The price is not right: Can the Fed bring down inflation without threatening economic growth?

For much of last year, the U.S. Federal Reserve (Fed) and many economists predicted that inflation would slow as the pandemic waned. Few believe that today. The key question now is: Can policymakers thwart inflation without thwarting global economic growth?

FUNDAMENTALS MATTER

Good things may come to those on the right side of volatility.

Several indicators point to a potential reshuffling of market leadership in the second half of 2022. This could spell potential opportunities for investors with the skills and research capabilities needed to seek them out.

FLEXIBLE FIXED INCOME

It's time to think beyond basic fixed income allocations.

Government bonds failed to buffer against equity market downturns in the first half of the year. This suggests that investors may need to expand their search for diversification across fixed income sectors and geographic regions.

MANAGING GEOPOLITICAL SHIFTS

Global politics have reshaped the investment landscape.

Russia's invasion of Ukraine could continue to pressure markets in a variety of ways, especially global commodity markets. Higher oil prices could accelerate the move to renewable energy.

Navigating Challenging Currents

Inflation-omics

Inflation is likely to dominate headlines, and financial market performance, in the second half of the year just as it did in the first. Although investors must contend with other economic headwinds—including the war in Ukraine, COVID-19 lockdowns in China, and central bank tightening—inflation is the risk that's directly influencing the value of assets from the supermarket to the stock market. While there have been anecdotal signs that inflation may be peaking—such as a slowdown in home price appreciation and cooling demand for labor—clearer evidence is needed.

2022 Has Gotten Expensive

Changes in price: April 2021 to April 2022

Fuel Oil ↑80%	Used Cars ↑23%	Eggs ↑23%
Transportation ↑20%	Coffee ↑15%	Clothing ↑5%

Inflation Hit a 40-Year High in 2022

Source: Bureau of Labor Statistics Consumer Price Index, April 2022

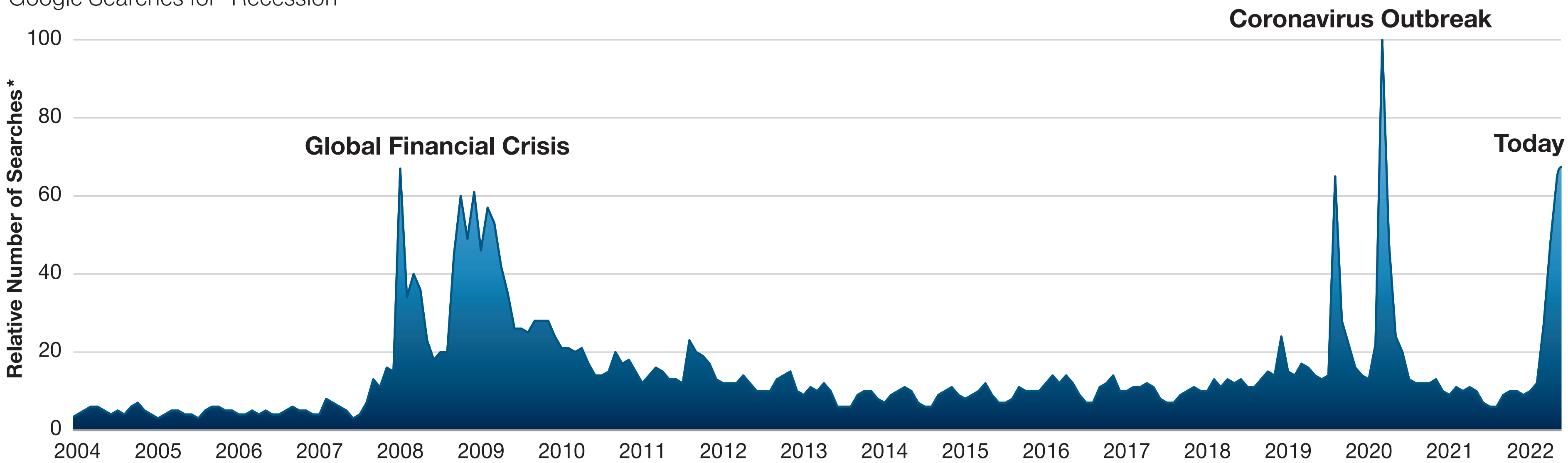
The Stock Market May Be Facing an Uphill Climb

In light of the pressures inflation is causing and exacerbating, many investors have begun to wonder whether we're in for a recession. Higher prices tend to slow consumer spending, the main engine of economic growth. And in order for the stock market to do its part, corporate earnings will have to continue to grow too—a challenge considering rising interest rates and higher wage and input costs.

On the monetary policy front, Fed policymakers will try to keep inflation at bay and economic progress on track, but they could force larger rate hikes, boosting recession risks. On a more optimistic note, there are factors that could support better economic outcomes. For example, meeting pent-up consumer demand by fixing supply chain bottlenecks—could help bring down inflation, taking some of the pressure off of central banks.

Recession Concerns Are Top of Mind

Google Searches for "Recession"



Source: Google. As of June 13, 2022.

*Numbers represent search interest relative to the highest point on the chart for the given region and time. A value of 100 is the peak popularity for the term. A value of 50 means that the term is half as popular. A score of 0 means there was not enough data for this term.

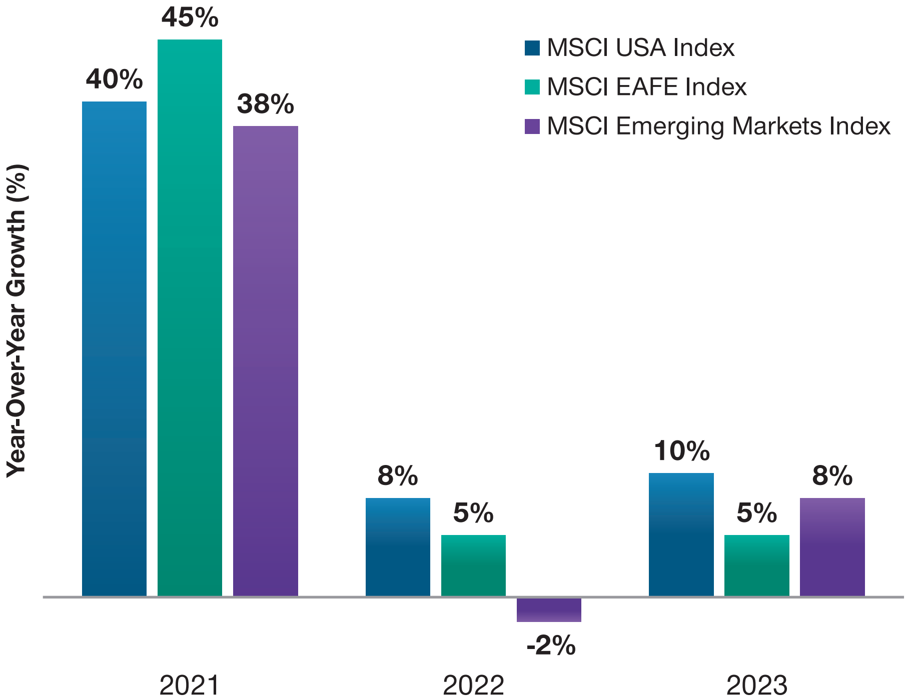
Fundamentals Matter

Unlocking Value in a Tough Market

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 more on the outlook for corporate earnings growth. And although earnings per share (EPS) growth in the U.S. remained surprisingly steady in the first half of 2022, it may decelerate in the second half, challenged by a slowdown in economic growth.

Earnings Growth Is Expected to Slow

EPS Growth Estimates as of May 31, 2022



Sources: MSCI, T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Returns in U.S. dollars. Please see last page for more information about this sourcing information.

Will We See a Shift in Equity Leadership?

Poor earnings environments have historically tended to favor the growth style, which is typically less threatened by cyclical downturns. But this time could be different, given the heavy weight the technology sector now carries in the growth universe. These factors suggest that the back-and-forth shift within market leadership seen since the pandemic recovery has tipped more decisively in favor of value.

Tactical Opportunities

- Expect less tolerance for unprofitable, speculative stocks.
- Dividends and earnings growth could become more critical to equity performance.
- A deep understanding of companies and industries could be key to consistently strong performance.

A risk to watch: Rising interest rates have already punished equity valuations. The question now is whether an earnings slowdown may be the next shoe to drop.

Flexible Fixed Income

Rethinking Fixed Income Allocations

U.S. Treasuries and other developed sovereign bonds did an exceptionally poor job of buffering equity volatility in the first half of the year. This suggests that investors may need to expand their search for diversification across fixed income sectors and geographic regions.

Is It Time to Extend Duration?*

A key issue for fixed income investors is whether bond yields could be close to a near-term peak, creating a potential opportunity to lock in portfolio income by extending duration. For U.S.-based investors worried about rising rates, global markets could offer diversification potential.

While the U.S. Federal Reserve is tightening, other countries—especially among the emerging markets—are further along in their interest rate cycles. Some have stopped raising rates. Others have even started cutting them. By taking advantage of this divergence in monetary policy, investors can seek to diversify interest rate exposure on a currency-hedged basis.

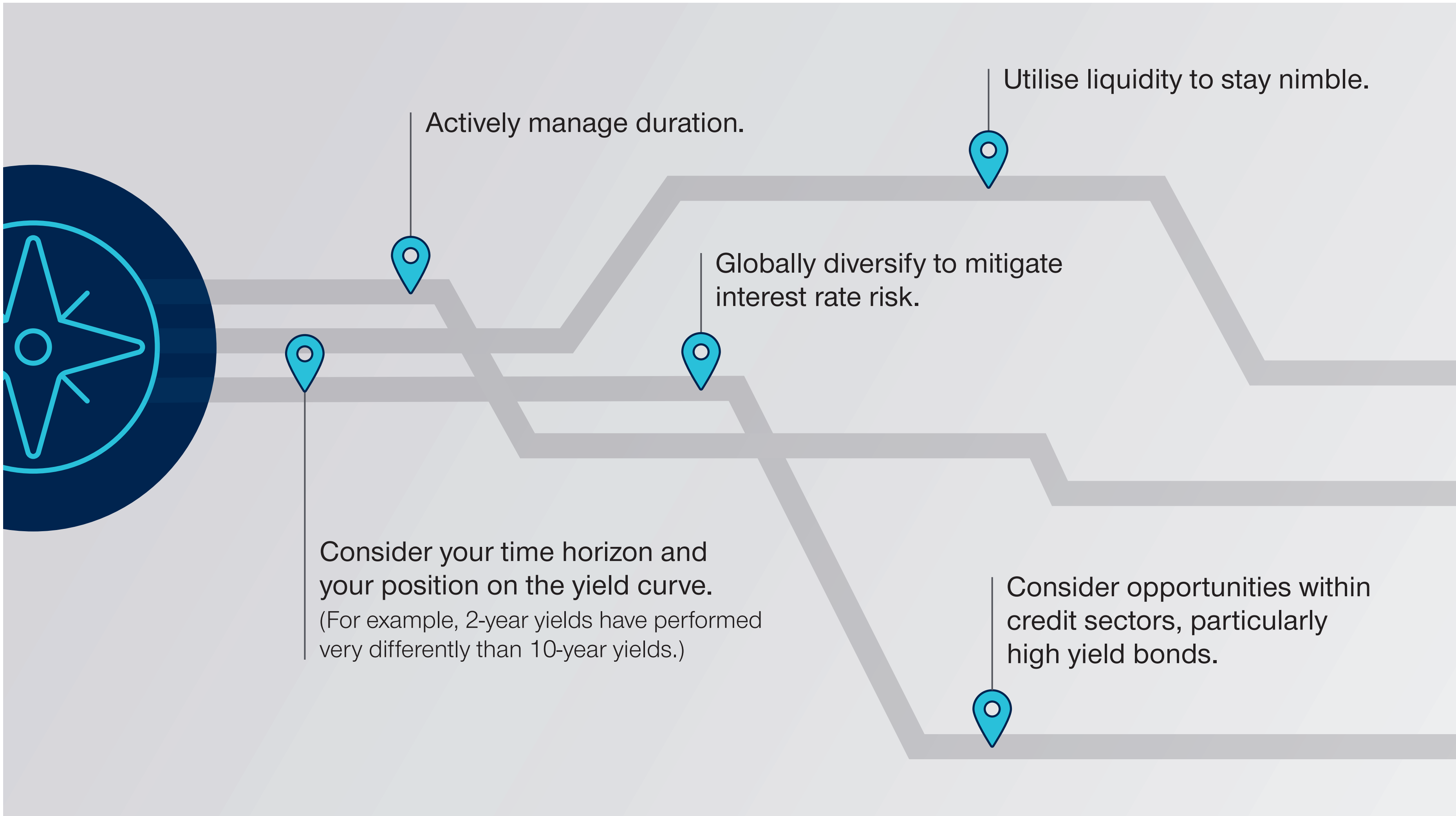
If yields do continue to rise, they should eventually reach levels that offer potentially attractive income opportunities for investors who understand how to manage duration—or who can rely on skilled investment professionals to do it for them.

*Duration refers to how long it takes for an investor to be repaid a given bond's price by that bond's total cash flows.

High Yield in Focus

In the case of some credit sectors, particularly high yield corporate bonds, yields may have already risen to relatively attractive levels. On top of compelling yield potential, the current risk of credit defaults is relatively low. As of May, high yield default rates remained near historical lows, and rating upgrades were more than twice as high as downgrades. Yet investors should proceed with caution given the specter of recession. A growth shock could quickly change the picture.

A Playbook for Navigating Volatile Bond Markets



Managing Through Geopolitical Risks

Spotlight on Ukraine

Russia's invasion of Ukraine has shaken the global political landscape. Beyond the immediate destruction and human suffering inflicted by the war itself, the conflict threatens to worsen hunger in the world's poorest countries, revive Cold War tensions, and obstruct international cooperation on problems such as climate change and nuclear proliferation.

Consequences of the War Could Be Disruptive Over Many Years and Sectors

The war's inflationary impact will be magnified in the developing world, where food products typically have a much heavier weight in consumer price indexes than in the developed world. The war also exposed Europe's dependence on Russia for oil and natural gas supplies. This will have implications not just for energy security, but for political issues related to energy equity, such as demands for consumer subsidies. Finally, sanctions placed on Russia, which could last years, further broadened the range of industries disrupted by this tragedy.

A Boost for Renewable Energy

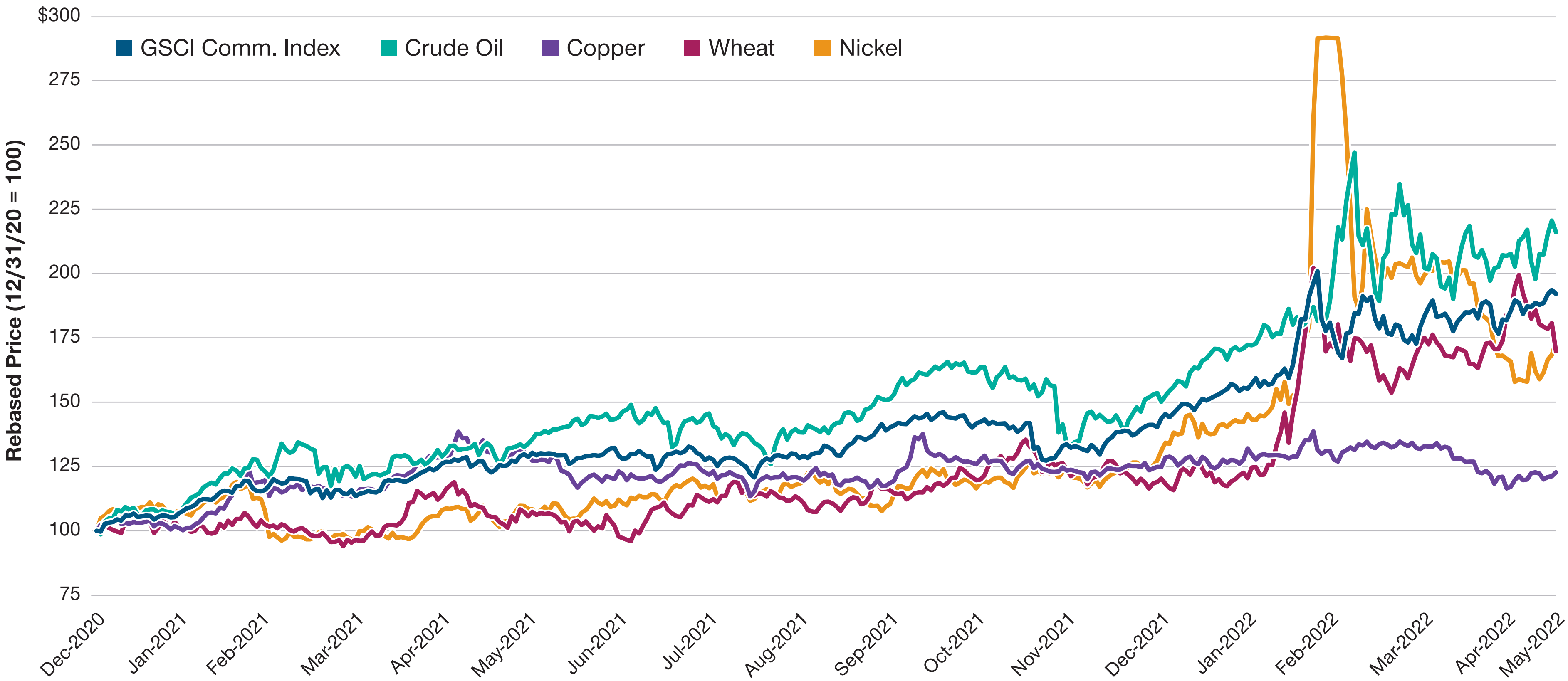
Like most economic disruptions, the energy shock has the potential to create investment opportunities as well as risks. The transition to renewable energy sources—such as wind and solar—could be one of them. As prices for hydrocarbons climb, the appeal of switching to renewable energy could become even more attractive. Higher prices also could spur investments throughout the energy supply chain—including upgrading electrical grids and developing energy storage technologies—which could boost demand for the rare materials used in those projects.

A Closer Look at Sanctions

The financial penalties imposed on Russia in response to the invasion could accelerate another longer-term transition—toward a less centralised global financial system. The initial round of sanctions included several unprecedented steps, such as freezing Russia's foreign currency reserves at the Fed and other cooperating central banks and banning some Russian banks from the SWIFT (Society for Worldwide International Financial Telecommunications) financial messaging system. As long as sanctions remain limited to Russia and its closest allies, they appear to pose limited risks to the global economy. But that might not be the case if secondary sanctions were imposed on other countries, particularly China, in response to actions perceived as aiding the Kremlin's war effort.

The War in Ukraine Is Feeding Commodity Inflation Worldwide

Price changes for selected commodities and weight of food in national Consumer Price Indexes.



Commodity prices December 31, 2020, through May 17, 2022.

Past performance is not a reliable indicator of future performance.

Sources: Haver Analytics/J.P. Morgan (see last page), and T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved.

Investment Themes to Consider

Navigating Challenging Currents

Investment Idea	Rationale
Defensive Positioning in Stocks	Earnings growth in the second half of 2022 could be challenged by slowing economies. Higher input costs also could cut into profit margins.
Inflation-Sensitive Stocks	While inflation is expected to decline from recent peaks, there are several factors that could keep upward pressure on prices. Unexpected interest rate hikes could cause downward pressure.

Fundamentals Matter

Investment Idea	Rationale
Less Rate-Sensitive Stocks	Higher interest rates could favor some value sectors, including financials. The growth style could be challenged by tough year-over-year earnings comparisons.
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.

Flexible Fixed Income

Investment Idea	Rationale
Globally Diversified Bonds	While the Fed and other major central banks are tightening, not all countries are at the same point in their monetary cycles. By taking advantage of divergence, investors may be able to diversify interest rate exposure.
High Yield Income	Higher interest rates and wider credit spreads (the additional yield over comparable U.S. Treasuries for bonds with credit risk) potentially create income opportunities for investors with the appropriate time horizons.

Managing Through Geopolitical Risks

Investment Idea	Rationale
Energy Infrastructure	The war in Ukraine has pushed oil and gas prices higher. This could accelerate the shift to renewable energy sources and boost investment in electrical grids and new energy storage technologies.

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