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INVEST WITH CONFIDENCE

PANORAMA

QUARTERLY THOUGHT LEADERSHIP PUBLICATION FOR OUR CLIENTS

THIRD QUARTER, 2022

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WELCOME.....

.....to the third quarter 2022 edition of Panorama, T. Rowe Price's investment magazine for Asian investors.

The first seven months of 2022 have not been an easy time for investors. A powerful mix of difficult economic conditions, rapid monetary tightening, and rising geopolitical concerns have left their mark on financial markets. Still, barring another large hike in commodity prices or further supply chain disruption, global inflation appears likely to peak in the second half of 2022, implying less upward pressure on interest rates. That in turn may bring some much-needed relief to equity markets and other risk assets.

Our lead article for this issue comes from Rahul Ghosh, a Portfolio Specialist for Global Equity Strategies based in Singapore. In it, Rahul notes that bear markets in equities are not uncommon, there having been 26 of them in the U.S. since 1928. Recessions also are part and parcel of the business and economic cycles. Equity multiples typically compress in advance. After the trough, as business and consumer confidence improve, earnings rebound and markets recover strongly.

Many countries have established net zero CO2 emission targets, making energy transition an important factor for investors to consider. Maria Elena Drew, T. Rowe Price's Director of Research for Responsible Investing, reviews some of the key issues in the road to net zero. In April 2022, our firm joined the Net Zero Asset Managers initiative (NZAMI), signaling T. Rowe Price's strong commitment to developing new investment products consistent with net zero objectives.

In our Global Multi-Assets (GMA) feature, Yoram Lustig and his team argue that challenging market conditions and deep structural shifts require fresh thinking from investors. This may include new ways to help mitigate the impact of volatility on equity portfolios, adapt the role of government bonds in multi-asset portfolios, and employ active management strategies to potentially benefit from market volatility. The GMA Solutions team believe these new ideas can help investors to better manage volatility while potentially generating positive real returns.

Next, Gabe Solomon, who manages T. Rowe Price's US Large-Cap Value Equity Strategy, explains why the current move in favor of U.S. value stocks could continue. The fundamental investment landscape in the U.S. looks to have shifted, as Gabe thinks core inflation could prove stickier than many investors currently expect.

Turning to Emerging Markets, Wenli Zheng answers some of the key questions received from clients concerning his China Evolution Equity Strategy, which seeks to invest in the whole of the China equity universe bar the top 100 largest companies by market cap. Wenli thinks that what's important for investors is not whether China can meet a specific GDP target, but whether the economic situation in China in a broad sense is improving or deteriorating.

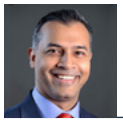
Finally, in our Personal Profile interview we spoke with Hari Balkrishna, the manager of T. Rowe Price's Global Impact Equity Strategy. Hari is committed to advancing the agenda of impact investing, assisting investors to support companies that we believe are on the right side of societal and environmental change.

We welcome your comments and feedback on this issue of Panorama investment magazine – our contact details can be found on page 25.

T. Rowe Price Australia

SOME THOUGHTS ON BEAR MARKETS AND RECESSIONS

Making sense of turbulent markets in 2022



Rahul Ghosh
Portfolio Specialist,
Global Equity Strategies

Recently, there have been many questions from investors around bear markets and recessions, and what that means for their portfolios. In this note we have condensed and collated some key thoughts in order to provide a framework to help investors analyze and understand the relationship between bear markets and recessions. To be clear – we are not saying that the U.S. or the world is already in recession, or that we believe we will enter a recession in the near future. Rather, this note provides a framework for investors to think about determinants and potential future outcomes. As a quick recap, bear markets are very often defined as price declines of at least 20% from the previous peak. Recessions are generally understood to mean a period of at least two consecutive quarters of declining economic activity or GDP.

[1] As of May 19, 2022.

FIGURE 1: Equity Markets Entered "Bear Markets" Territory in June
Percentage change from 52-week high.

	52 Week High		Index Level as of 6/14/22	Change	# days
	Date	Index Level			
NASDAQ Composite Index	11/22/2021	16,212.2	10828.4	-33%	204
Russell 1000 Index	01/04/2022	2672.00	2050.08	-23%	161
S&P 500 INDEX	01/04/2022	4818.62	3735.48	-22%	161
STOXX Europe 600 Price Indewx E	01/04/2022	495.46	407.32	-18%	161
MSCI ACWI Index	01/04/2022	761.21	593.77	-22%	161

Past performance is not a reliable indicator of future performance.
All data and analysis is as of June 14, 2022.
Sources: Bloomberg Finance L.P.

Bear Market Levels Breached

Looking at recent declines from highs, as of June 14th the Nasdaq is most clearly in bear market territory, while other major indices like the MSCI ACWI / S&P500 / Russell 1000 have just breached those levels.

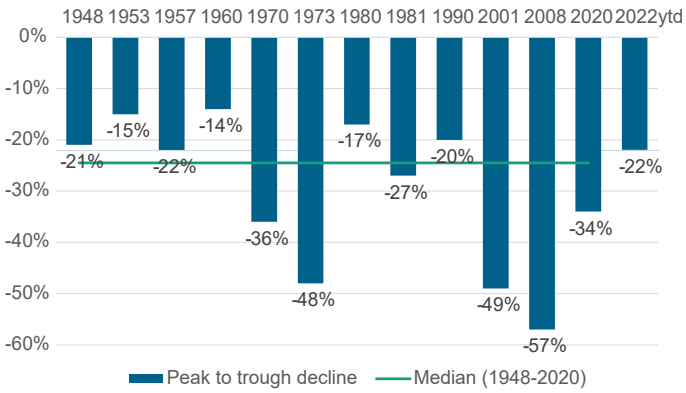
Market declines in 2022 have not been uniform. What is interesting is that the swoon of the Stoxx 600 in Europe was not as far advanced as the fall in the S&P 500. But this is likely to do with composition as a larger proportion of the European equity market is in more defensive sectors such as healthcare (13.7%), or commodity beneficiaries such as oil & gas (6.8%).[1] That stands in contrast to the S&P 500, where IT at around 28%[1] is the largest single sector, with energy having only a small share at 3.7%.[1]

Some Stylized Facts About Bear Markets

Here are some key facts and figures about bear markets, taking the U.S. experience and the S&P 500 as an example:

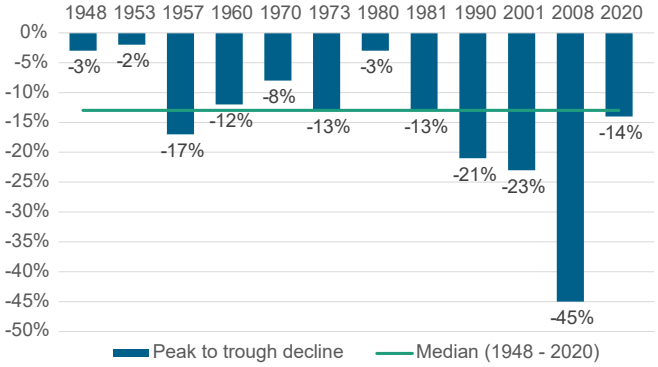
1. **Bear markets are not unusual.** Since 1928 all told there have been 26 bear markets in the S&P 500.
2. **Bear markets tend to be shorter than bull markets.** The average length of a bear market is 289 days, (about 9.6 months). With the S&P500 having fallen 22% as of 6/14/2022, we are currently 161 days through this downturn, so approximately half of the average time taken (The longest bear market on record was in 1973-74 at 630 days, while the shortest was in 2020 at the onset of the coronavirus pandemic). Bull markets by comparison have averaged 991 days (2.7 years).
3. **Average losses in bear markets.** Since 1948 stocks have lost 36% on average in a bear market. By contrast, stocks have gained 114% on average during a bull market.
4. **A bear market doesn't necessarily indicate an economic recession.** There have been 26 bear markets since 1929, but only 15

FIGURE 2: S&P 500 Declines Around Recessions Since WWII
Peak-to-trough declines for each recession versus the median.



Past performance is not a reliable indicator of future performance.
As of May 18, 2022.
Source: Goldman Sachs Global Investment Research.

FIGURE 3: S&P 500 Earnings Declines in Recessions Since WWII
Peak-to-trough S&P 500 Last Twelve Months EPS decline.

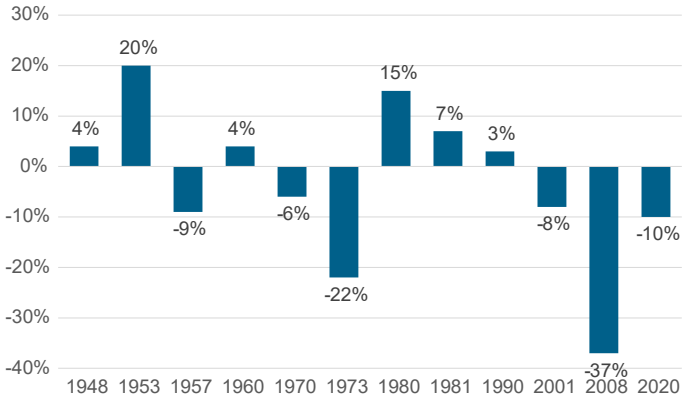


As of May 18, 2022.
Sources: Goldman Sachs Global Investment Research.

[1] As of May 19, 2022.

FIGURE 4: Equity Performance During Recessions Since WWII

Percentage change in S&P 500 in recessions as defined by NBER.



Past performance is not a reliable indicator of future performance.
Sources: T. Rowe Price analysis using data from Bloomberg Finance L.P., National Bureau of Economic Research.

recessions. What investors need to keep in mind is that bear markets tend to track a slowing economy, but a declining market doesn't necessarily mean that a recession is looming.

Recessions And The Equity Market

We next consider recessions and their relation to equities and what potential lessons history may have for us, again using data from the U.S. and the S&P 500 for convenience.

So far we have had one quarter of negative QoQ growth in US GDP (-1.4% annualized for Q1 2022, first reported on April 28). According to Bloomberg, the expectation of a US recession in the next 12 months is quite high at 31.5%. Markets are arguably pricing in an even higher recession risk when investors consider the magnitude of the peak-to-trough move in the S&P 500 in 2022 versus history.

Some observations on recessions:

1. **Frequency and amplitude.** Since the end of the second World War there have been 12 recessions in the U.S. and the median peak to trough decline in the S&P 500 has been 24%. The average decline has been greater at around 30% (left tail risk).

   If we think of the largest drawdown in the S&P 500 this year of 22% to June 14 versus the average decline in a recession, that could be taken to imply that markets then were pricing in a 22/30 = **75% probability of recession.**

   A key point of timing worth noting is that peak-to-trough market declines don't necessarily reflect the performance of the market for the duration of a recession. Markets are forward looking and usually discount much of the bad news in advance. Thus the S&P 500 has had positive returns in half of the recessionary periods since 1948.

2. **Multiple contraction.** The market P/E multiple typically starts contracting ahead of a recession. Research by Goldman Sachs indicates that since 1980, the market multiple on average has peaked 8 months before the recession and contracted by a median of 21% from peak-to-trough. Looking at the S&P 500 market multiple in 2022, it had come down by around 20% by the May low before stabilizing in early June.

3. **Earnings in a recession.** For the same postwar period discussed above, earnings for the S&P 500 dropped by some 13% around recessions (median decline). Currently, the market is still forecasting decent earnings growth for 2022, but recently consensus earnings have been cut by 1% compared to previous estimates.

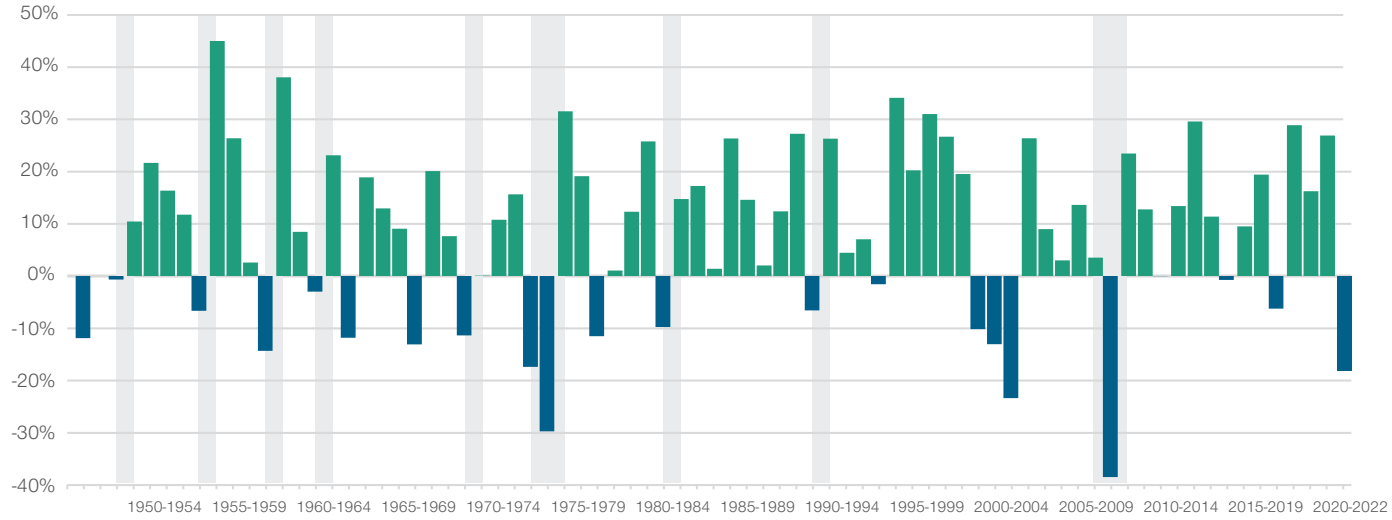
   History would suggest that **equity analyst cuts are a lagging indicator.** Since 1990, the median EPS cut ahead of a recession was about 10%, while the next 6 months from the start of a recession saw further significant earnings downgrades of around 13%.

4. **Markets move in advance.** Research indicates that across these 12 instances of recessions since WWII, equity markets began to price a recession on average **7 months before** the official recognition of a U.S. recession by the NBER (National Bureau of Economic Research).

Relevance to Today's Markets

It's been said that "History doesn't repeat itself, but it often rhymes". Given what markets currently appear to be pricing in and the amount of uncertainty in the environment, it may be useful for investors to try and frame the analysis and match it to potential outcomes. Based on the median historical peak-to-trough market decline in a recession would imply further mid to high single digit falls in the S&P 500 are likely should a recession unfold. If one were to assume that earnings were to similarly mirror past revisions, then arguably there might be further downside for equities of around 13% (assuming no major further external shocks to the economy).

FIGURE 5: Market Performance around Recessions
Annual percentage change in S&P 500



Past performance is not a reliable indicator of future performance.
As of June 14, 2022.
Source: Bloomberg Finance L.P., National Bureau of Economic Research.
There is no guarantee that any forecasts made will come to pass. Actual results may vary.

But **some things are different today,** and **there are also positives from history** that are worth paying attention to.

1. **Earnings tend to bounce back after recessions.** While median earnings have fallen 13% on average around recessions, in the four quarters following the trough median earnings have rebounded by 17%.
2. **Growth outweighs contractions.** Excluding the Great Depression from 1928-1939, US recessions have lasted **an average of about 10 months.** The recession which followed the global financial crisis in 2008 was unusually severe and lasted 18 months. On the other hand, the economic expansion that followed is the longest on record and lasted for more than 10 years.
3. **Stock markets can perform even in recessions.** Stocks have actually returned positive performances in 6 of the 12 recession periods post WWII as defined by the NBER. Moreover, when looking at market performance after periods of recession, it has tended to be quite strong.

Figure 5 shows the annual performance of the S&P 500 with NBER recession periods shaded grey. What one can see clearly from the chart is that more often than not, equity returns over the 12-24 months following a recession have been strongly positive.

Global markets have performed quite differently in 2022. Some markets appear to be further along the bear market path than others. A number of Asian markets, for example, peaked a while ago and have already experienced significant drawdowns. In contrast, developed European equity markets have so far been more resilient, though they face the challenge of higher energy prices in the second half due to the sanctions on Russia and slowing activity. The recent end to China's Covid lockdowns combined with further policy easing has triggered an improvement in sentiment towards Asian equity markets.

Concluding Thoughts

None of this is to suggest that we are either already in or about to enter a recession. Rather it is a reminder that recessions are part of the business and economic cycle. And while every recession will likely have a different cause, there are some similarities in how they play out in markets – multiples compress in advance, earnings cuts follow, and then post the trough as business and consumer confidence expands we typically see earnings respond robustly, with a strong market recovery.

Keeping pullbacks and market corrections in proper perspective is important and they should be a time for investors to analyze and assess the risks compared to the opportunities that the market presents. As Warren Buffett has said, it is wise for investors to be “fearful when others are greedy, and greedy when others are fearful”. But it also clearly helps to truly understand what we as investors are fearful of.

THE ROAD TO NET ZERO

How the world is moving forward on emissions reduction.

- Many countries have now established net zero targets—making energy transition an important factor from a fiduciary responsibility perspective.
- Data availability has continued to improve in that more companies are choosing to report, but a lack of standardization is still an issue.
- We are seeing a demand for products that invest in companies that finance climate solutions, commit to greenhouse gas reduction targets, or both.

Maria Elena Drew
Director of Research,
Responsible Investing

Many entities, including federal and regional governments, corporations, universities, and investors are setting net zero targets—as the world looks to tackle climate change. Net zero means achieving a balance between the greenhouse gases (GHG) put into the atmosphere and those taken out. This state is also referred to as carbon neutral. The focus on net zero targets accelerated in 2021 and was one of the key objectives of COP26 (the 2021 United Nations Climate Change Conference). Coming out of the summit, more than 140 countries—accounting for 90% of global greenhouse gas emissions—had established net zero targets.[1]

The fact that so many countries have made this commitment makes energy transition an important factor from a fiduciary responsibility perspective. The net zero emissions reduction trajectory is a severe one—it requires a 50% reduction in GHG emissions between 2020 and 2030 and reaching net zero by 2050. It is incomparable with any energy transition that has ever taken place in modern history. Even if governments only partially achieve their goals, it will be highly disruptive to industry and macroeconomic trends.

> The net zero emissions reduction trajectory is a severe one....

[1] Source: The Climate Action Tracker—an independent scientific analysis that tracks government climate action and measures it against the globally agreed Paris Agreement aim of "holding warming well below 2°C, and pursuing efforts to limit warming to 1.5°C."

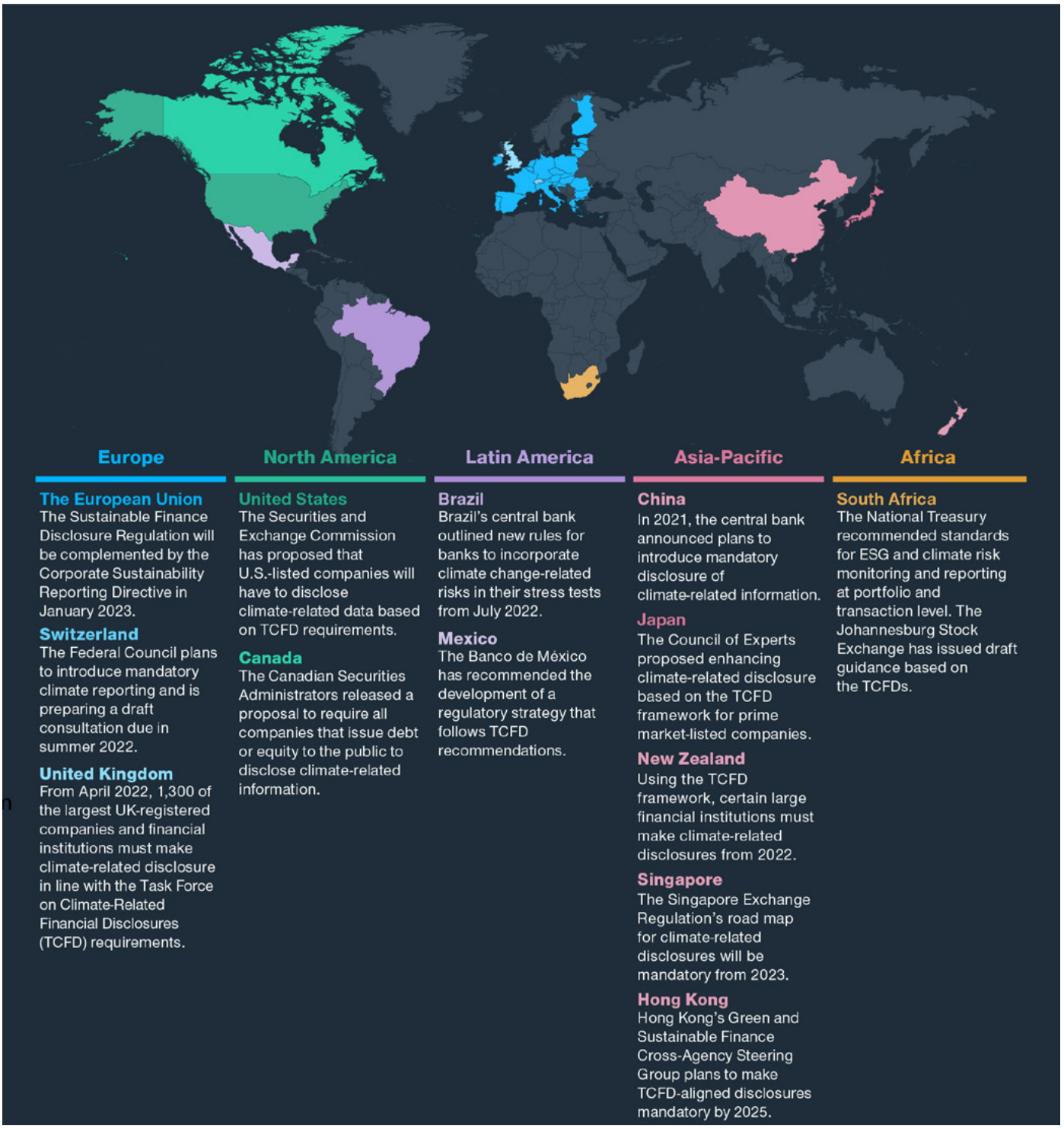
Looking at the enormity of the task at hand, many want to do their part to aid the energy transition. At T. Rowe Price, we see this in demand for products that invest in companies that finance climate solutions, commit to GHG reduction targets, or both. To this end, we have joined the Net Zero Asset Managers initiative and are committed to developing investment products with net zero objectives to help meet the needs of these clients.

Politics: What's Happened and What to Expect

The COP26 summit held in Glasgow last November was driven by climate urgency. The impact of climate change has become much more real to politicians as major storms and other weather events are becoming more prominent. Whether or not the summit was successful is in the eye of the beholder. Technically, success should have been gaining agreement for all

FIGURE 1: The Rise in Mandatory Climate Reporting

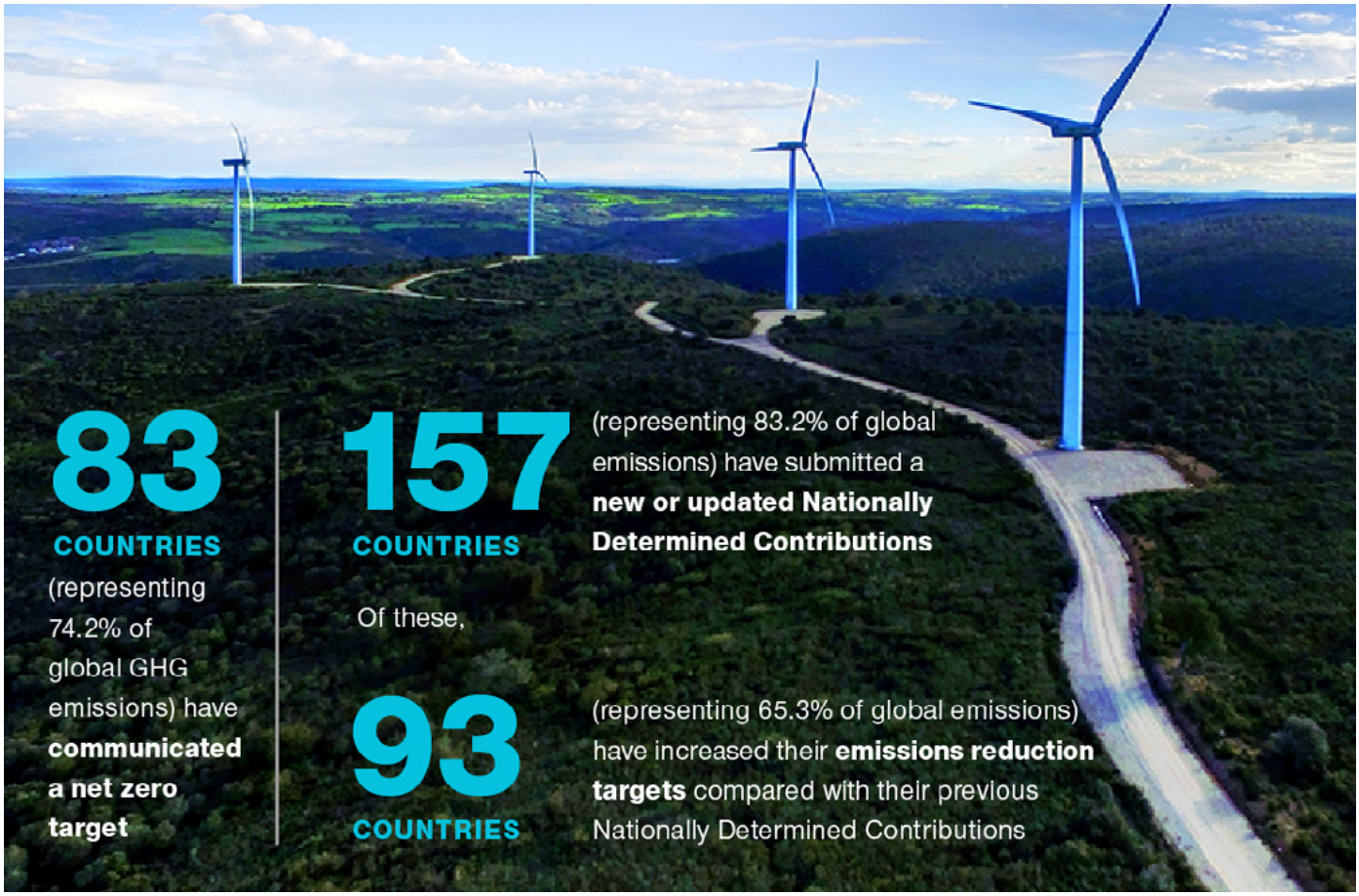
Will compulsory climate reporting become the norm?



As of March 31, 2022.
Sources: S&P Global Sustainable, Allen & Overy, Norton Rose Fulbright, Sustainable Stock Exchange Initiative. Analysis by T. Rowe Price.

FIGURE 2: Global Commitments to Greenhouse Gas Reductions

Current NDCs are falling short



As of March 2022.
Current aggregate Nationally Determined Contributions (NDCs) fall short of what is needed to reach net zero by 2050.
Source: Climate Watch. 2020. Washington, DC: World Resources Institute. Available online at: https://www.climatewatchdata.org. World Bank. 2017. Nationally Determined Contributions (NDCs). Available at: http://spappssecext.worldbank.org/sites/indc/Pages/INDCHome.aspx.

parties to limit global warming to 1.5°C, backed up with Nationally Determined Contributions (NDCs)—plans submitted by each nation that detail how they will deliver on GHG reductions. That did not happen as the aggregate NDCs fell well short of net zero 2050, but, given the enormity and difficulty of the task at hand, that probably was not a realistic expectation for COP26.

While politicians may have done well for the hand they were dealt, COP26 can only be viewed as a failure through the lens of climate change math. A range of estimates have come out regarding the commitments made at Glasgow, which imply a warming scenario of at least 1.8°C–2.1°C at the end of the century. The 1.8°C estimate comes from the International Energy Agency and has been criticized for making some heroic assumptions.[2] The 2.1°C estimate assumes full implementation of the NDC targets and has a heavy reliance on strong progress being made between 2030 and 2050. More realistically, the Climate Action Tracker highlights that the 2030 targets are not ambitious enough and would put us on course for 2.4°C of warming.

As part of the Glasgow agreement, countries will resubmit their NDCs ahead of COP27 and have specifically been asked to improve their 2030 targets. A key take-away from the talks is an acceptance that countries will meet more frequently to review their targets and measure progress against them.

Another giant gap in the equation for investors is corporate disclosure of GHG emissions data, something we also discussed in last year's ESG Annual Report. Data availability has continued to improve from a year ago in that more companies are choosing to report, but a lack of standardization is still an issue (which means that when two companies report their GHG emissions, the comparison may not be apples to apples). Regulators are starting to address the issue, but reporting GHG emissions is still not mandatory in most places.

[2] The International Energy Agency. As of November 4, 2021.

Evaluating Climate in Investments

With more than 140 countries (accounting for 90% of global greenhouse gas emissions) having established net zero targets, understanding how our investments are positioned in this changing landscape is essential to fulfilling our role as an asset manager. Similarly, many of our clients recognize this potential investment risk and want to understand how their portfolios are positioned regarding the energy transition. To this end, we provide quarterly greenhouse gas footprint profiles for a range of investment portfolios that we manage, where enough data are available.

> ...isolating climate into a single factor such as GHG footprint can be misleading....

Of course, isolating climate into a single factor such as GHG footprint can be misleading—it would be akin to financial analysis taking only the income statement into account and ignoring valuable insights from the balance sheet and cash flow statement. A GHG footprint gives you a "point in time" analysis and misses key items, such as the historic and forward trajectory of emissions and exposure to climate solutions. More importantly, a myopic view on GHG footprints could lead an investor to investing only in low emitters, thereby ignoring the prospect of GHG reductions in the real economy.

In recognition that net zero is a complex topic that cannot be boiled down to a single data point, we are committed to expanding transparency around climate reporting. Due to data availability and other limitations, this will take time—but we are committed to continued progress.

Investment Products Targeting Net Zero

Some clients want to go further than considering energy transition as an investment risk—by specifically targeting GHG reduction as an investment goal. A good example is the Net-Zero Asset Owner Alliance. The UN-convened alliance includes 71 asset owners controlling more than USD 10 trillion that are committed to transitioning investment portfolios to net zero greenhouse gas emissions by 2050.

We have been working with clients that are members of the Net-Zero Asset Owner Alliance as well as other clients looking to set GHG reduction targets on their portfolios. This is something that can be more easily accomplished when the client (typically institutional) has set up their own separate account. Committing to a specific GHG reduction target limits the investment universe and, by default, prioritizes an environmental target over financial performance—not every client in an existing pooled asset would want this to take place.

Nevertheless, we recognize that there are many clients who wish to apply net zero targets to their investment portfolios but, for various reasons, need to rely on pooled investment vehicles. For this reason, we are seeking to develop investment products with net zero objectives to meet their needs.

Ultimately, by signing up to the Net Zero Asset Managers initiative we are illustrating our commitment to developing products with net zero objectives. It also underlines our intention to help promote best practices and create industry standards around net zero portfolios. ■

The Net Zero Asset Managers Initiative

As of April 25, 2022, T. Rowe Price has become a signatory of the Net Zero Asset Managers initiative (NZAMI).

NZAMI is an international group of asset managers committed to supporting the goal of net zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5°C. It launched in December 2020 as a sibling organization to the Net-Zero Asset Owner Alliance, with the aim of galvanizing the asset management industry to provide products suitable for asset owners committing to net zero goals.

NZAMI has grown to include 236 signatories with USD 57.5 trillion assets under management (as of December 31, 2021).[3]

[3] Source: netzeroassetmanagers.org.

WINNING BY NOT LOSING: BUILDING PORTFOLIOS FOR A MORE CHALLENGING WORLD

Generating positive returns in tougher conditions requires new thinking.

- Challenging market conditions and deeper structural shifts are demanding fresh thinking from investors.
- Such thinking may include new ways to help mitigate the impact of volatility on equity portfolios, adapt the role of government bonds, and use active management to potentially benefit from market volatility.
- We believe that ideas such as these will help investors to manage losses while potentially generating inflation-beating returns.

Yoram Lustig
Head of EMEA Multi-Asset Solutions

Michael Walsh
Multi-Asset Solutions Strategist

Niklas Jeschke
Multi-Asset Solutions Analyst

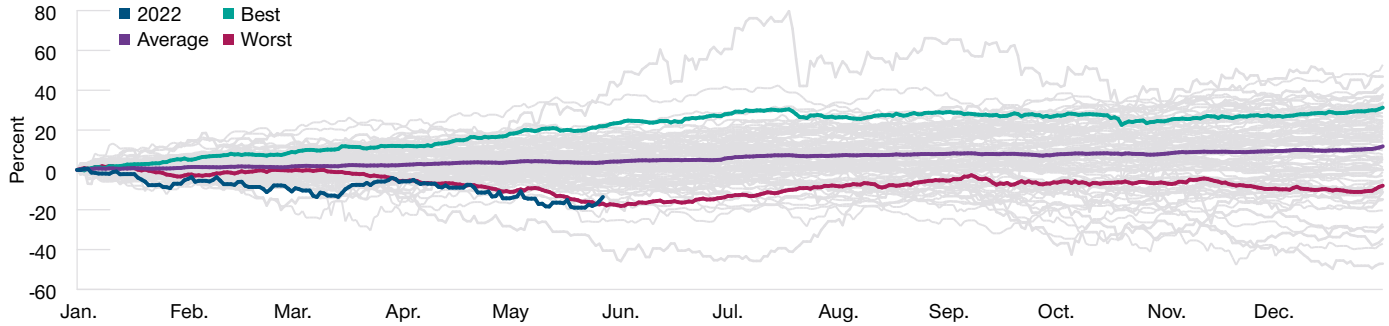
Eva Wu
Multi-Asset Solutions Analyst

The first five months of 2022 have not been easy for investors. A powerful cocktail of difficult economic conditions and rising geopolitical concerns have made their mark: The S&P 500 Index was down by more than 12% from January 1 to May 31—its worst record over that period since 1970 (Figure 1).[1]

In recent years, multi-asset investors have generally been able to rely on their fixed income holdings to cushion the blow if equity markets fell. However, these diversification benefits were notable for their absence over the first four months of this year. As equities plummeted, U.S. fixed income

[1] **Past performance is not a reliable indicator of future performance.** The 10 years since 1928 with the lowest total return for the S&P 500 Index from the beginning of each year through May 31: 1932 -45.0%, 1940 -25.2%, 1962 -15.8%, 1970 -15.5%, 1931 -15.1%, 2022 -14.1%, 1939 -11.2%, 1938 -10.7%, 1941 -10.6%1973 -10.5%. The 10 years with the higher total returns: 1933 42.0%, 1975 35.4%, 1943 23.4%, 1987, 21.3%, 1991 20.8%, 1983 19.9%, 1954 19.3%, 1986 18.8%, 1995 17.1%, 1985 16.7%.

FIGURE 1: The S&P 500's Start to 2022 Was Its Worst in 50 Years
It was down by 14% from January to May 31, 2022



As of May 31, 2022.
Past performance is not a reliable indicator of future performance.
Sources: S&P 500 Index (see Additional Disclosures). Analysis by T. Rowe Price. Based on daily total returns measured in U.S. dollars. January 1928 through May 31, 2022. Average is average return of all years. Best is average return of 10 years with highest returns. Worst is average return of 10 years with lowest returns.

was hit by its worst drawdown since 1980[2]—in fact, it was the first time since at least the mid-1970s that the U.S. equity and fixed income markets both experienced a drawdown more severe than 10% at the same time (Figure 2). These losses were especially painful in inflation-adjusted terms, as rapid price increases across many major economies led to the purchasing power of investments falling even more.

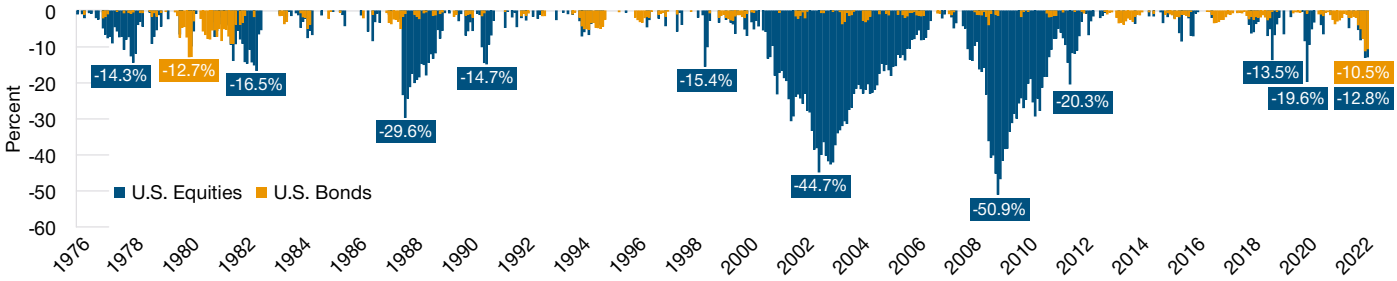
There seem to be five main reasons for the continued declines of global equity and fixed income markets so far this year: (1) the accelerated pace of monetary tightening by central banks such as the U.S. Federal Reserve, (2) persistently high inflation, (3) concerns over slowing economic growth, (4) disruptions caused by China's strict zero-COVID policy, and (5) Russia's invasion of Ukraine.

Another factor behind the uncertainty is that markets are simultaneously undergoing several structural shifts: from pandemic lockdowns to reopening, from low and stable to high and volatile inflation, from super-accommodative monetary policy to tightening, from globalization to a focus on local supply chains, and from U.S. hegemony to a realignment of powers. Still recovering from the shock of COVID, the world must now contemplate a slew of new challenges. During structural shifts, investors and markets need to adapt—and adaptation typically involves uncertainty and volatility.

> *During structural shifts, investors and markets need to adapt....*
>
> ***— Yoram Lustig***
> *Head of EMEA Multi-Asset Solutions*

What can investors do to generate positive inflation-adjusted returns in this market environment? Or, to put it another way, where can they lose the least money? To help achieve these objectives, we have identified three investment ideas, each of which is shaped around one of the possible regimes that lie ahead.

FIGURE 2: Equities and Bonds Fell in Tandem Over the First Four Months of the Year
It was their worst parallel drop since the mid-1970s



As of May 31, 2022.
Past performance is not a reliable indicator of future performance.
Sources: S&P 500 Index, Bloomberg U.S. Aggregate Index (see Additional Disclosures). Analysis by T. Rowe Price. Based on monthly total returns measured in U.S. dollars. February 1976 through May 2022.

[2] **Past performance is not a reliable indicator of future performance.** Fixed income is represented by the Bloomberg U.S. Aggregate Index.

1. Managing Equities in a Time of Volatility

Major equity market indices have fallen by between 13% and 23% from their peaks in 2022,[3] bringing previously elevated valuations into "reasonably priced" territory. Over the long term, valuations—measured by price to earnings (P/E) ratio—are a significant driver of equity market performance (Figure 4).

At the end of December 2020, the S&P 500's valuation implied a potential near zero total return for the index over the next decade based on historical experience. Following the sell-off in equity markets seen so far in 2022, the relative valuation now implies about a 7% total return per annum over the next decade. In other words, the equity risk premium may have staged a comeback.

> *The market is already pricing in a much higher probability of negative events....*
>
> ***— Michael Walsh***
> *Multi-Asset Solutions Strategist*

Equity exposure is the strategic cornerstone of most multi-asset portfolios, and we are currently modestly underweight equities. However, gradually building exposure using dollar cost averaging to avoid betting on a single buying price, with a focus on more beaten-down areas, could generate long-term inflation-beating returns. The market is already pricing in a much higher probability of negative events playing out than it did at the beginning of the year. This will soften the blow if such events materialize. Conversely, some cyclical areas may rerate higher if worst-case scenarios can be averted.

FIGURE 3: Three Investment Ideas for a Changing World
Striving to generate positive returns in a period of structural change

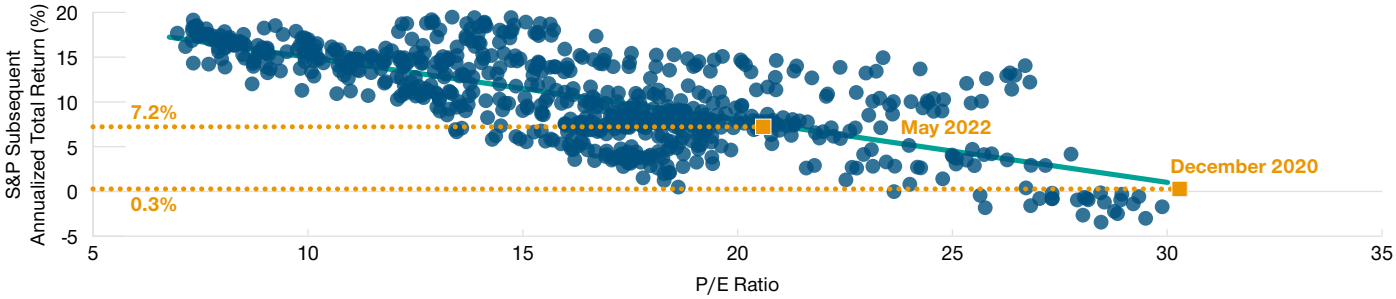
Investment Idea	New Thinking
Managing equities in a time of volatility	Downside risk mitigation, global diversification, and dynamic management.
Rethinking the role of government bonds	Sharp rises in yields means safe-haven bonds are again ready to play their traditional role of equity diversifier as well as a source of stable income.
Balancing market and active risk	Allowing portfolios to adjust as the market environment adapts—volatility is the friend of the skillful active manager.

Source: T. Rowe Price.

For truly long-term investors, investing in equities has been, and remains, one of the best ways to help generate attractive returns. However, to get to the long term, investors need to survive the short term. Until some of the imbalances affecting markets recede, volatility is likely to persist. To help smooth the ride, investors should consider the following ideas:

- **Mitigating downside risk.** Consider techniques and listed derivative overlays to help mitigate volatility and downside risks, focused on minimizing the drag on performance. Our diversified tail-risk mitigation program is an example of this.
- **Using diversified diversifiers.** Consider diversifying across global equity markets. This may include more esoteric areas such as frontier markets and involve different equity style blends, thereby ensuring exposure to areas such as growth, value, and small-caps.

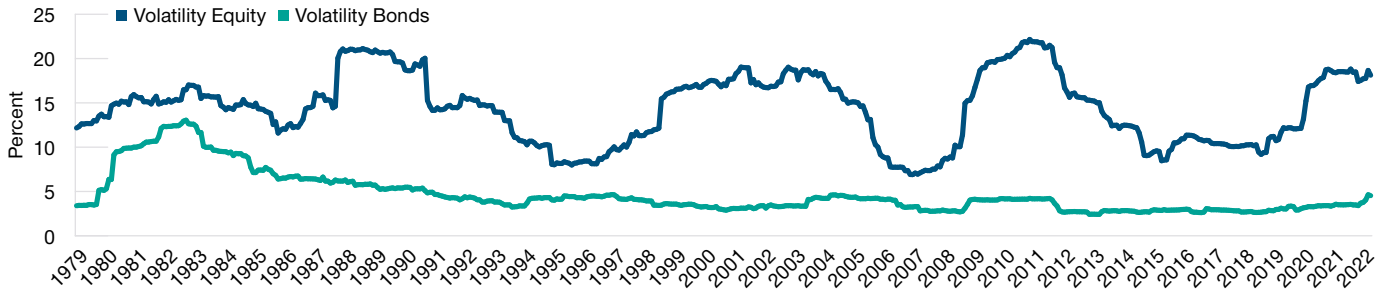
FIGURE 4: Valuations Are a Key Driver of Equity Market Performance
Low P/E ratios typically lead to stronger subsequent returns



As of May 31, 2022.
Past performance is not a reliable indicator of future performance.
Sources: S&P 500 Index (see Additional Disclosures). Analysis T. Rowe Price. Based on monthly total returns measured in U.S. dollars. The orange dots represent values of P/E ratio as of December 2020 and May 2022. For the period January 1954 through May 2022.

[2] **Past performance is not a reliable indicator of future performance.** MSCI All Country World Index (ACWI) has declined about 13.0% from its peak on November 16, 2021, through May 31, 2022. The NASDAQ Composite has declined about 22.5% from its peak on November 19, 2021, through May 31, 2022.

FIGURE 5: Equity Market Volatility Has Increased Over the Past Two Years
It was low between 2013 to 2020



As of May 31, 2022.
Past performance is not a reliable indicator of future performance.
Sources: S&P 500 Index, Bloomberg U.S. Treasury Index (see Additional Disclosures). Analysis T. Rowe Price. Based on monthly total returns measured in U.S. dollars. Volatility (annualized standard deviation) is calculated using rolling 36 months. For the period January 1979 through May 2022.

- **Dynamically managing portfolios.** Consider making portfolios more dynamic; for example, by actively controlling the volatility of the overall equity portfolio within a desired range.

2. Rethinking the Role of Government Bonds

One of the challenges so far in 2022 has been that both equity and bond markets have fallen at the same time, making diversification difficult. In recent years, many investors have moved away from high-quality government bonds as long-term yields around zero meant little prospect of positive returns from such holdings. However, after the recent rise in yields, there may be more scope for government bonds to resume their traditional role of safe havens in the event of a very negative economic or geopolitical outcome. In addition, inflation-linked bonds are one of the few assets offering cash flows that increase in line with inflation.

With higher yields, the "price" of safety has come down. Indeed, one reason for the weakness in equity markets in 2022 has been that government bonds have become more attractive. Some investors, satisfied with a modest but predictable nominal return, have rotated from riskier equities to bonds.

If inflation persists, economic growth remains solid, and central banks continue to tighten their policies, government bond yields may keep rising and government bonds may deliver negative total returns. Nevertheless, portfolios balancing equities and bonds should perform well because equity gains are likely to outweigh bond losses under these circumstances.[4]

On the other hand, if inflation recedes, growth slows, and central banks discontinue tightening policy, bonds may generate positive returns and diversify equity risk.

To mitigate the risk of bond losses, the following may help:

- **Adopting a global approach.** Tapping the global government bond market, instead of the local one, while systematically hedging overseas currency exposure offers diversification and a wider investment opportunity set.
- **Adding selective currency exposure.** Allocations to safe-haven currencies, such as the U.S. dollar and Japanese yen, may add to equity diversification at times of stress.

> *...there may be more scope for government bonds to resume their traditional role of safe havens....*
>
> ***— Niklas Jeschke***
> *Multi-Asset Solutions Analyst*

- **Allocating to inflation-linked bonds.** A strategic allocation to inflation-linked bonds is one way to add some protection against inflation.

3. Balancing Market and Active Risk

Equity and fixed income markets have rallied strongly over the past two decades, which has meant that index exposure has often been sufficient to generate the returns required by investors. Beating inflation at the current level of around 8%[5] is a much bigger hurdle. Even if current supply issues unwind and geopolitical tensions abate, inflation expectations have moved sharply upward—market expectations for U.S. inflation are about 3% per annum[6] over the next five years.

[4] Our paper "Putting the Fed's Planned Rate Hikes into Context" from February 2022 found that the U.S. equity market delivered a positive total return 17 times out of 21 hiking cycles in the 12 months after the first hike over the period from January 1974 to December 2021.

[5] April 2022 readings of the consumer price index (CPI) year-on-year change were 8.3% in the U.S., 7.4% in the eurozone, 9.0% in the UK, and 2.5% in Japan.

[6] U.S. 5-year break-even inflation of 2.96% per annum as of May 31, 2022.

> *For skillful active managers, volatility is a friend.*
>
> ***— Eva Wu***
> *Multi-Asset Solutions Analyst*

An extra boost may be needed to deliver positive after-inflation returns in this environment.

While equity volatility was low between 2013 to 2020, it has subsequently increased, offering more opportunities for active management to add value.

For skillful active managers, volatility is a friend. It creates opportunities, especially when widening the dispersion of prices across investments and sending prices away from intrinsic values. The following ideas may help investors capitalize on these.

- **Actively managing traditional asset classes.** An increased level of market volatility and an uncertain macro environment create winners and losers, rewarding skilled equity and fixed income managers.
- **Using liquid alternatives.** With uncertain returns forecast for equity and fixed income markets, alternatives may prove their worth within a diversified portfolio. Investors need to treat each alternative on a case-by-case basis, ensuring clarity on why an alternative strategy is included within their portfolio and what to expect in different market conditions.
- **Embracing multi-asset investing.** Large-scale adjustments to portfolios against a turbulent market backdrop can be challenging. Multi-asset investing can bring these ideas together, dynamically blending different sources of returns and adjusting portfolios as markets adapt to new regimes and as new strategies or risk management techniques become available.

Adjusting to a Tougher Environment

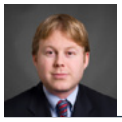
The investment environment has become more challenging. New market conditions under new regimes require new thinking. We believe investors face a period of lower market returns, less predictable inflation, and higher volatility. We have listed three investment ideas for consideration to help investors manage losses while potentially generating inflation-beating returns. The old ways of investing may give way to new ones. ■

Active management does not ensure a favorable outcome, and there is no assurance that any investment objective will be achieved. Diversification does not assure a profit or protect against loss in a declining market.

THIS TIME, THE U.S. VALUE ROTATION MAY HAVE LONGEVITY

More persistent inflation and rising interest rates change the landscape.

- The emergence of inflationary pressure in the U.S. has sparked polarizing debate about how high, and for how long, it might rise.
- A dramatic shift in the narrative from the U.S. Federal Reserve early in 2022 suggests that the fundamental landscape has changed.
- While we anticipate moderation in some shorter-term inflation components, other sources could prove stickier than many expected.



Gabe Solomon
Portfolio Manager,
US Large-Cap Value Equity Strategy

Inflation has become a focal point for U.S. investors over the past year as consumer prices have surged amid the post-pandemic reopening of the economy. Understandably, this is causing a great deal of uncertainty as, for many, the prospect of a world of more persistent inflation and rising interest rates is unfamiliar. However, while we anticipate inflation easing from current elevated levels over the coming months, we also believe that a fundamental change in the investment landscape is underway, thus supporting a potentially more sustainable rotation into value-oriented investments.

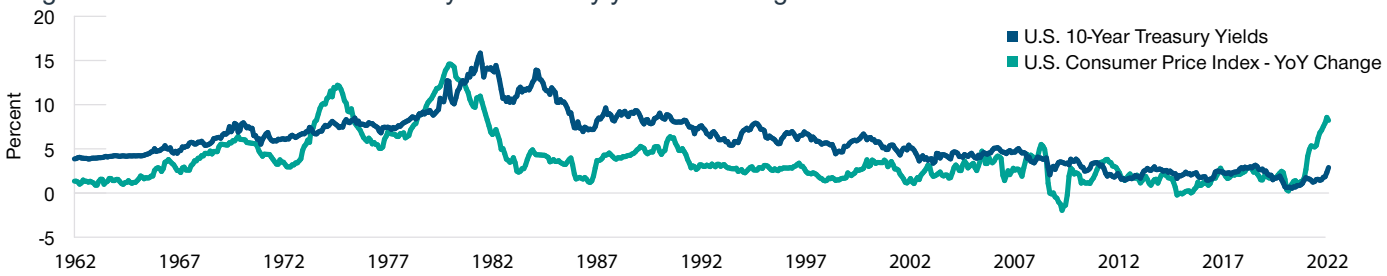
The "Sticky" vs. "Transitory" Inflation Debate

Early in 2021, as U.S. inflation started to move sharply higher, debate raged between those who expected higher prices to prove transitory and those who thought the emerging inflationary pressure was likely to remain more stubbornly elevated. Throughout this time, across the T. Rowe Price U.S. Value franchise, we have been more inclined

> ...we have been more inclined toward the latter camp, believing that inflation was likely to prove longer lasting than many—including the U.S. Federal Reserve—had initially expected....

FIGURE 1: U.S. Inflation vs. Treasury Yields

Heightened U.S. inflation has seen 10-year Treasury yields move higher



As of April 30, 2022.
U.S. annual consumer price index inflation versus U.S. 10-year Treasury bond yields.
Source: FactSet. Copyright 2022 FactSet. All Rights Reserved. Analysis by T. Rowe Price.

toward the latter camp, believing that inflation was likely to prove longer lasting than many—including the U.S. Federal Reserve—had initially expected. This non-consensus view has subsequently proved significant in our decision-making over the past 12–18 months.

Market Rotation May Have Longevity This Time

Unlike previous rotations to value, which in recent years have proved to be fleeting, we believe that the current move could have greater longevity as the fundamental landscape appears to have shifted. A key indication of this can be gleaned from the U.S. Federal Reserve and the dramatic change in its narrative in recent months. Until late 2021, the Fed was still talking about rising inflationary pressure as being transitory in nature, thereby requiring little policy action to be taken during 2022. More recently, however, the statements from the Fed have notably dashed all mention of "transitory" from its inflation narrative. And from its previous position of potentially not having to act in 2022, the Fed has proceeded to hike rates by 75 basis points in the first four months of the year to rein in supply-driven inflation.

Accordingly, for the first time in many years, there is growing conviction that the Fed will need to raise interest rates materially. For value investors, this is a pivotal development given the historical correlation that exists between rising U.S. Treasury yields and the relative performance of more value-oriented market sectors. Rising inflation/interest rates tend to support value because the profit from value stocks typically comes sooner whereas growth stocks are typically more profitable further into the future. As inflation picks up and interest rates rise, future profits have to be discounted at a greater rate, making them worth relatively less today.

Furthermore, the relative valuation differential that currently exists between U.S. growth and value shares, which remains around all-time wide margins, means certain parts of the market—stocks with the highest valuation multiples—are even more sensitive to movements in bond yields. As such, we could potentially see some exaggerated internal market swings toward value.

Economic "Normalization" Is the Fed's Priority

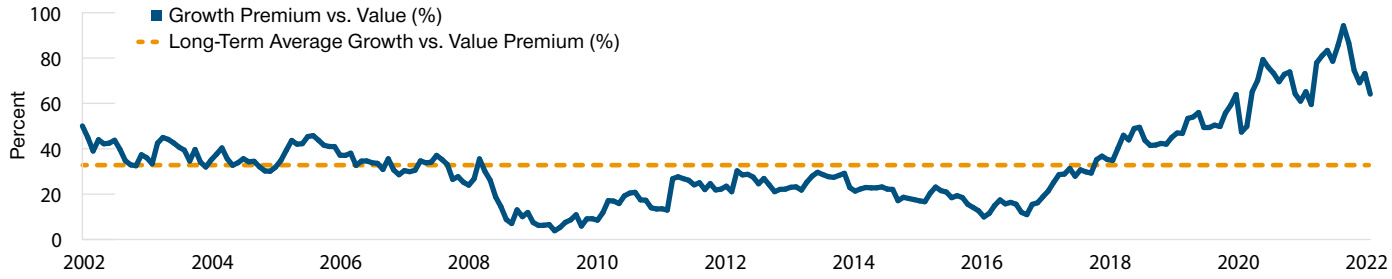
The Fed is clearly focused on achieving economic normalization and may yet have to move even faster with policy action in order to cool inflation. Our base case is that headline measures of U.S. inflation are likely to peak within the next several months before gradually declining. Importantly, however, we do not anticipate a return to the ultralow inflation/interest rate landscape that the world has become accustomed to over much of the past two decades.

Recent measures of inflation are elevated due to a mix of both transitory and longer-lasting elements. And while we anticipate moderation in some of the shorter-term components, other prominent sources, such as wage growth, could prove stickier than many previously expected. Similarly, housing/real estate expenses also represent a large component in most inflationary measures, and the trajectory of the U.S. housing market remains firm in our view. The significant disruption to global supply chains caused by the coronavirus pandemic and, more recently, the Ukraine crisis is also likely to see more companies eschew globalization in preference for a more local/regional business focus. Many U.S. manufacturing businesses, for example, can no longer reliably depend on components coming out of Asia, given ongoing battles with the coronavirus. This expected refocusing on locally sourced/produced components, therefore, is likely to see an increase

[1] As of 30 September 2021. Sources: Bloomberg Finance L.P. FactSet. Financial data and analytics provider FactSet. Copyright 2021 FactSet. All Rights Reserved.

FIGURE 2: Relative Premium of U.S. Growth vs. Value Over Past 20 Years

Down from recent peak, but still almost 2x the long-term average



As of April 30, 2022.
Comparison valuation premium of Russell 1000 Growth Index (Growth) versus Russell 1000 Value Index (Value) over a 20-year period. The long-term average Growth vs. Value premium is 33%. Valuation premium calculated as difference in comparative daily value of Russell 1000 Growth Index versus value of Russell 1000 Value Index.
Source: FactSet. Copyright 2022 FactSet. All Rights Reserved. Analysis by T. Rowe Price.

in overall costs for U.S. companies, which would ultimately flow through to higher-priced goods.

Balancing Near- and Longer-Term Opportunities

Our constant aim is to manage the portfolio with a balanced view of risk versus return opportunities. Many holdings within the portfolio have been near-term beneficiaries of the changing fundamental environment that we are seeing currently. Several of our investments with commodity-related exposure, for example, responded favorably over recent quarters. Investors appear to have gained a new appreciation for the importance of these companies within the global economy and the underlying value of their long-term strategic assets.

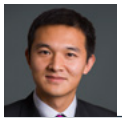
> ...by taking a long-term view, and by being willing to weather some near-term uncertainty, we can build meaningful positions in what we believe are quality businesses....

On the other side of the ledger, however, we also have investments in companies that underperformed over recent quarters. Several of our consumer staples companies fall into this category. Each of these businesses is grappling with rising input costs, and this is putting near-term pressure on profit margins. Importantly, however, we know these companies well, and each has a history of being able to increase prices over time to offset rising cost pressures and support margins. Once again, by taking a long-term view, and by being willing to weather some near-term uncertainty, we can build meaningful positions in what we believe are quality businesses with the potential to address these issues over time.

As we continue to move through the post-pandemic economic recovery, we believe that we will ultimately see more persistent U.S. inflation and higher interest rates. This would mark a potentially fundamental shift in the landscape that we have become accustomed to over the past 20 years—and one that would prove highly supportive of value investing—as investors refocus on the appeal of near-term profits bought at lower prices. Moreover, there remains a good opportunity to benefit from the still historically wide valuation differential that exists between value and growth-oriented market areas. ■

CHINA: EMBRACING UNCERTAINTY AND IDENTIFYING GOOD OPPORTUNITIES

An attractive combination of risk and return.



Wenli Zheng
Portfolio Manager,
China Evolution Equity Strategy

By way of introduction, the China Evolution Equity Strategy that I manage has what we believe is a unique design among China equity funds. We invest in the whole of the China equity universe, but excluding the top 100 largest listed companies.[1] The Chinese stock market has around 6000 public companies, with less than 100 having a market cap above USD30 billion. However, among mainstream China funds, many invest around 60% of their portfolio in these mega cap stocks. So around 60% of assets are invested in less than 2% of the investment universe.[2] We regard this as a major disconnect in terms of diversification and breadth of opportunity.

The first objective of the China Evolution Equity Strategy is to offer a unique exposure to the 98% of the opportunities that are under-explored. As a key design feature, we do not aim to invest in the top 100 Chinese mega-cap stocks. A second element of the portfolio

[1] By market cap.
[2] The top 100 largest listed companies in China by market cap represent around 2% of the opportunity set in terms of the total number of companies.
As of 30 June 2022. Sources: Bloomberg Finance L.P. FactSet. Financial data and analytics provider FactSet. Copyright 2022 FactSet. All Rights Reserved.

design is that we take a holistic, style agnostic investment approach. We are not constrained by growth or value. Rather, we look for stocks that have a combination of fundamental strength and mispricing opportunities. We do that through the process of discovery, deep research, and pattern recognition.

A third feature of portfolio design is a strong focus on alpha generation. We believe that the 98% of the universe that we operate in has more mispricing opportunities and aim to identify these with a flexible investment approach.

Q1: Chinese equities have rebounded since May while other major markets have stayed weak. Has investor sentiment toward China turned the corner?

Looking back over recent quarters it is clear with hindsight that Chinese equities encountered a 'perfect storm.' Beijing started to tighten liquidity as far back as the second half of 2020, much earlier than the rest of the world. On top of that tighter macro policy stance, you had all the regulatory actions that took investors by surprise, and which lasted throughout 2021.

At the beginning of this year, the new omicron Covid strain posed a major threat to China's strict zero-Covid plus a new round of geopolitical concerns triggered by the Russia-Ukraine conflict.

Over the past 1-2 months, we have started to see improvements in many aspects. The policy priority has shifted from tightening to supporting growth. We would expect a more favorable liquidity and regulatory environment for the coming quarters.

The COVID situation has improved and the supply chain is largely back to normal. We still see small scale outbreaks in a few cities, which inevitably impact local service business. However, we think another major supply chain disruption can hopefully be avoided.

Lastly, rising raw material prices, which hurt the margins for many Chinese industrial companies, have started to come down. This should help the earnings growth for mid/down stream companies in China.

Since mid-March Chinese and global equity performance has diverged, with MSCI China gaining 20.4% as the MSCI AC World Index fell by 10.6% (in USD, 15/03/22 to 13/07/22. Source: Bloomberg Finance L.P.). Despite this rebound, I don't get the sense that sentiment has suddenly turned overly bullish. The sense I get is that investors feel that the worst is probably behind us, and the economy should improve in the second half of the year.

Q2: With some light at the end of the tunnel, in China's case has the bad news largely been discounted?

I think the Chinese economy has passed the phase of sharp deceleration seen in the first half of 2022. We do not expect large scale stimulus, but believe things will be improving in the coming quarters. The question is about what the slope of the improvement would look like.

One thing I want to highlight is that I think China is in a unique position when it comes to its business cycle. With inflation remaining muted at around 2.5% in June according to government data, the central bank has enough leeway to loosen. While most other major economies are on a tightening cycle to contain high inflation rates that have not been seen in decades. This could put China's market in a relatively better position.

The result of the different economic picture can be traced back to COVID response. In the first COVID wave, most countries responded to what was essentially a supply issue by stimulating aggregate demand. With hindsight, that's a recipe for high inflation. China, on the other hand, focused on cutting taxes for enterprises and protecting employment. The result is that supply chains and productivity are maintained, but demand has been relatively weak.

I think what's important for investors is not whether China will meet a specific GDP growth target of 5.5%. Rather, it's about whether the economic situation in a broad sense is improving or deteriorating. China's equity market is broad and deep. As long as the economy stabilizes, there are ample bottom up opportunities for investors.

Q3: Wenli, turning to your portfolio what changes have you made in 2022?

We are bottom-up investors and we don't construct the portfolio based on our macro views. We go through the whole opportunity set and try to identify stocks with the most attractive risk reward profiles. There are three buckets where we find interesting opportunities.

The first bucket is a group of unique businesses that we believe can compound at 20%+ for the next 3 to 5 years. The sharp selloff earlier this year offered us the

opportunity to acquire some of them at an attractive price. That includes a leading EV startup, an online recruiting platform, and a shopping mall operator.

The second bucket is what we call the nonlinear grower. These are companies that we think will go through meaningful earnings acceleration driven by product cycle or operation improvement. Examples include an auto display and a pharmaceutical packaging company. We expect both to benefit from a sharp increase in ASP (average selling price) driven by product upgrades.

In the third bucket are companies facing short-term margin pressures because of rising raw material prices. They are proven businesses, and we think margin pressures are likely to reverse over the next one to two years. This category includes a leading gas distributor in China as well as an instant noodle manufacturer.

On the flip side we have also been making some disposals. That includes stocks that benefited from the pandemic and supply chain disruptions. Their margins are at multiyear highs and could be difficult to sustain. Examples include some IC (integrated circuit) design companies, container shipping businesses, and small appliances manufacturers.

In some other cases, we are making the changes to adapt to evolving trends. For example, the structural shift in the property market and demographic change (low birth rate) could have long-term consequences for some of our holdings and we have made some adjustments accordingly.

Q4: Do you see electric vehicles (EV) as a big opportunity for investors in Chinese equities?

I think EV could be a major driver for China's industrial upgrade over the next 5 to 10 years. China's auto market is seven to eight times larger than the smartphone market[3] and we see similar dynamics between the two industries. China is the largest auto market globally but local OEMs had a relatively weak position in ICE (internal combustion engine) cars with less than 40% market share. However, Chinese companies' position in EV is much stronger with a share in the local market of more than 80%. (Source: T. Rowe Price analysis of industry data, as of June 2022). Over time, we believe they could potentially play a meaningful role in global EV markets as well.

That potentially could bring huge opportunities across the whole supply chain. Including battery makers, auto parts companies, equipment suppliers, and automation/software vendors.

Our focus in EV, besides selected EV OEMS, is mainly on auto parts companies with strong competitive positioning and content gain opportunity. For example, we think there is potential for auto glass's value per car to go up 2-3 times over the next several years driven by EV and innovations. Similarly for auto display, we see both rapid content gain as well as market consolidation as auto screens become larger with high specifications. Another area of content gain is auto relays, where high voltage from EV can drive ASP 2 to 3 times higher.

The EV transition is expected to lead to rapid changes in the competitive landscape as well. For example, one of China's leading gearbox manufacturers has only an 8% market share in the traditional ICE market. However, for the EV market, the manufacturing process requires far greater precision and this added complexity creates higher barriers to entry. As such this company has achieved a 50% market share gaining a dominant market position. (Sources: T. Rowe Price analysis, Company disclosure FY2022).

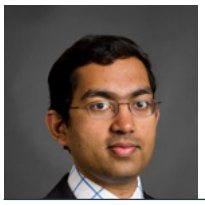
Q5: Lastly, what happens if a portfolio holding were to break into the ranks of the top 100 Chinese mega cap stocks?

The China Evolution Equity Strategy seeks to invest in potential future winners at an early stage of their life cycle. Compounders are rare, and once we find them, we hope to stay invested and let them compound value for our clients. So no, we don't have to sell when our portfolio companies become mega cap stocks. However, we constantly evaluate each position in our portfolio. There should be good reasons in order for the mega caps to remain in the portfolio. They'll have to continue to meet our expected return target and still have strong growth prospects. ■

[3] T. Rowe Price ballpark estimate for illustrative purposes only, as of June 2022. Actual outcomes may differ materially from estimates. Estimates are subject to change.

MEET HARI BALKRISHNA

An interview with Hari Balkrishna
Portfolio Manager, Global Impact Equity Strategy



Hari Balkrishna
Portfolio Manager, Global Impact Equity Strategy

BIOGRAPHY

Career

Hari Balkrishna is a portfolio manager for the Global Impact Equity Strategy. He is a vice president of T. Rowe Price Group, Inc., and T. Rowe Price International Ltd..

Hari's investment experience began in 2004. He has been with T. Rowe Price since 2010, beginning in the equities department. He was a research analyst covering European banks, autos, real estate, and Canadian banks from 2010 to 2015 and an associate portfolio manager of the Global Growth Equity Strategy from 2015 to 2020. He was appointed portfolio manager of the new Global Impact Equity Strategy in March 2021.

Prior to this, Hari was employed by Goldman Sachs in Sydney for four years in the financial institutions group of the Investment Banking Division.

Professional & Education

Hari earned a bachelor of commerce degree in finance and accounting (university medal and first-class honors) from the University of New South Wales and an M.B.A., with distinction, from Harvard Business School.

With 15 years of investment experience and a passion for environmental and social impact, Hari Balkrishna is passionate about managing the Global Impact Equity Strategy. He believes the market is ready for investors seeking to make a more active and conscious choice to favor companies that seeks to deliver positive environmental and social impact.

Tell us about your background and how you started your investment career

After finishing my bachelor's degree, I knew that I wanted to work in asset management as I always loved the accountability and game theory of financial markets but wasn't quite able to break in right after university. I instead spent four years in investment banking in Sydney, Australia with Goldman Sachs before deciding that it wasn't for me and applied to business school – to globalize my knowledge base and break into professional asset management.

During my time pursuing an M.B.A. at Harvard Business School, I completed a summer internship with T. Rowe Price working as an analyst in the London office. I covered the banking sector, which was undergoing huge change after the global financial crisis in 2008. Upon gaining my MBA, I accepted a role as an Investment Analyst at T. Rowe Price covering European and Canadian banks, autos, and real estate.

Prior to my role as Portfolio Manager for the Global Impact Equity Strategy, I was an associate portfolio manager for the Global Growth Equity Strategy for six years working with Scott Berg. This was a fantastic grounding in globalizing one's investment knowledge across sectors, but more importantly building and deepening working relationships with all our analysts, sector portfolio managers and diversified portfolio managers around the world.

What attracted you to "impact investing"?

At a personal level, having lived and worked in five different continents, I have built an appreciation for different social constructs, and have always been a passionate believer in solving for climate change. The strategy was born through our desire to contribute in a positive way to the challenges our planet and society face today. We believe impact investing is the most direct way we can influence and address these challenges—via conscious action, engagement, and skilled execution. It goes beyond simply owning and capturing the economics and activities of certain types of companies. Capital must also be directed toward desired impact outcomes, alongside engaging with company management and active proxy voting to help achieve the best results.

Impact investing also brings a non-financial dimension to the investment process – a values-based approach that seeks positive environmental

and/or social impact as part of distinct performance targets, that is material, measurable and additional. We believe that impact investing is key to putting investors on the right side of societal and environmental change. Capital can be directly deployed into positive impact and change-enabling companies. But this has to be combined with fundamental analysis, deep research, and valuation discipline.

Can public equity investing really make an impact on key environmental and social concerns, especially when compared to private investing?

While originally the domain of private investors, we believe the potential to capture and create impact in public equity markets has broadened tremendously over the past decade. Ambitious international and local goals are being set on environmental and social initiatives to directly address risks and promote change. Among them are the United Nations Sustainable Development Goals (UN SDGs), a globally recognized framework that aims to end poverty, protect the planet, and ensure prosperity. On its own, it is estimated that approximately USD 2.5 trillion of capital will be needed annually until 2030 to achieve the UN SDGs objectives.

If we aspire to accelerate these and other initiatives that target social and environmental transitions, it is essential to fund them at scale and in a liquid manner—so public equity markets will be critical to that effort. The enormity of issues like clean energy transition will not be possible without the backing of large and well-funded publicly listed firms.

Excitingly, the opportunity to own businesses that create a positive environmental or social impact is greater than ever before in public equity markets, as companies shift investment to address environmental and societal pressure points.

How do you make a difference for clients as an impact investment manager?

We aspire to be a partner to our clients, using our full breadth of ideas to harvest both impact and alpha over the long term. Impact investing has grown tremendously in recent years, in part because investors are not being asked to accept a sacrifice of potential returns in order to implement a values-based approach.

Part of my role as an impact investment professional is helping individuals and institutions make sense of what's happening in the world around us, and how that could manifest into risks and opportunities within an investment portfolio. For example, as the environmental costs of climate change accelerate, planning for the future and thinking about climate mitigation can genuinely help a company's bottom line.

As businesses become more conscious and active in aligning capital with the economic returns that can legitimately flow from addressing environmental or social tensions, I expect opportunities to grow. That is important because breadth is a key foundation of consistency and meeting the return objectives of impact investing. In short, we are in an era of growth with respect to the opportunity set of impact stocks, and it would be a privilege to help our clients access these opportunities.

From an alpha perspective, we also believe impact-oriented companies can offer better top line and bottom-line growth opportunities than the index. Often these companies have products that are in high demand from consumers, but also have business models that regulators wish to incentivise as we try to achieve net zero targets.

Can an investment manager contribute to positive impact?

Impact is achieved within an investment portfolio in more ways than simply owning and capturing the economics and activities of certain types of companies. It involves directing fresh capital towards desired impact outcomes, alongside impact-oriented company engagement, proxy voting and the associated influence feedback loop.

As a start point, we screen companies from an impact lens for both materiality and measurability of the desired outcome. This requires an understanding of a business in the context of a defined impact framework. For us, this is driven by a combination of evaluating a company's current and future operations and the alignment of earnings or revenues with our proprietary impact pillars and the United Nations Sustainable Development Goals (UN SDGs). We use the word 'future' very deliberately, given the rapid evolution of many businesses and the need to look forward.

Importantly, as a truly global asset manager, we are ready to supply new capital to areas of target impact. We use our position of ownership to enter into dialogues with companies where we can see the potential to accelerate the good aspects of their operations, while helping to mitigate the negative parts which naturally exist even in the purest of business operations. Change takes time and require

resilience, but this is consistent with many aspects of successful long-term investing.

How does your portfolio differ from the theme/ factor of ESG, Sustainability or even Impact?

It is important to distinguish that Impact investing is not ESG integration, and it is also a different discipline from sustainable investing. It does however incorporate both but takes it a step further. Impact investing in public equity markets lives in the same domain as other styles of investing. We do not believe there needs to be a sacrifice of return potential and we believe the opportunity set is unrecognisable from a decade ago. Impact investing is also outward (planet and society) and forward looking, versus ESG integration and sustainability that tend to look at a company's own operations much more.

But impact investing backed by stock picking outcomes requires equal, if not greater, levels of due diligence to avoid excessive concentration, crowding, and disappointment. A forward-looking perspective, a stable and expert research foundation, and a good level of imagination are key features of successful investment processes.

What does the future look like for "impact investing"?

Change is often born of extremes—and we are living in a period of extremes in many respects. The challenges of our era have created open and broad debates about the rights and freedoms of humankind, the growth in inequality, and the clear and obvious pressures on our environment. To this point, rarely have society and investors mobilized in the way we have seen in the past two years, with clear and raised expectations as to how businesses should conduct themselves in the context of the societies and the environments in which they operate.

We are encouraged by the significance and action businesses are applying to demands for new and improved principles. Companies are innovating in response to society's demands for solutions to pressing issues, and industry leaders are adapting in recognition of their responsibilities. This has created an increasing number of opportunities to access positive impact within public equity markets.

Share with us your personal interests and how they might (or might not) intersect with your professional work.

I strongly believe in the importance of work/life balance. I have two children with a range of interests, and I enjoy spending as much time with them as possible, especially playing cricket and squash with them. I also love cycling, playing squash and badminton.

I co-chair the London Corporate Responsibilities Committee, which is an opportunity to allow T. Rowe Price associates to have an impact on our local communities. It is extremely rewarding work where we can make a real difference to the communities around us. Volunteering and charity work is also a daily reminder of the purpose of impact investing – trying to channel capital towards making a difference and making the world a better place. ■

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

USD1.31
trillion in assets under management[1, 2]

821
investment professionals worldwide[3]

Local presence in
16
countries[3]

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[1] Firmwide AUM includes assets managed by T. Rowe Price Associates, Inc. and its investment advisory affiliates.
[2] As at 30 June 2022.
[3] As at 30 June 2022

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