T. Rowe Price®
INVEST WITH CONFIDENCE

2023 Midyear Market Outlook

Finding the Signal Through the Noise

FOR ACCREDITED INVESTORS ONLY. NOT FOR FURTHER DISTRIBUTION.

Executive Summary

MACRO

Despite a surprising start to the year, mixed market data suggest caution moving forward.

We've avoided recession so far in 2023, but global economies aren't out of the woods yet. Higher interest rates and tighter liquidity will have major implications for investors for the rest of the year.

FIXED INCOME

Not all bond markets rebounded, but we see opportunities for skilled active managers.

An inverted yield curve should make investors think twice before jumping into longer-term U.S. bonds. However, credit sectors and international markets offer return potential.

EQUITIES

With an eye on earnings, investors position themselves to handle an uncertain future.

Earnings growth estimates may continue falling in the second half of 2023. Still, we believe there are opportunities in U.S. small-cap stocks, mega-cap technology, and international markets.

> Skilled active management can help investors avoid riskier exposures.
>
> **Sébastien Page**
> Head of Global Multi-Asset and CIO

INVEST WITH CONFIDENCE®

MACRO

Economic Resilience Tested

Markets aren't sending clear signals.

As we look forward to the rest of 2023, the key themes of inflation, monetary policy, and recession risk will shape the investment environment. However, stock and bond markets are pricing in different scenarios for what's ahead, providing an unclear outlook. In this context, effective active investing is about finding which market signals you should heed and which ones you can ignore.

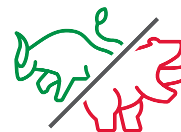
Economic reports in the first half of 2023 generally painted a grim picture, with many indicators pointing to a recession. But those warnings could be misleading—or at least incomplete. In many cases, the sharp declines seen in market indicators like Purchasing Managers' Indexes, consumer confidence, and the U.S. money supply have been from inflated levels reached during the coronavirus pandemic and its aftermath.

For example, household savings balances are coming down, but they remain extremely high by historical standards because of pandemic stimulus measures. Similarly, healthy consumer and corporate finances could also mitigate the economic impact of tightening credit conditions following the failure of several U.S. regional banks.

A key question: Which way will interest rates go?

Some financial indicators could be sending confusing signals about the direction of central bank policy. The market is trying to reconcile two very different scenarios:

The U.S. economy remains strong and the Fed doesn't cut rates.



Things go terribly wrong and the Fed has to cut rates by several hundred basis points.

Barring an abrupt crisis, it's most likely that rates will remain higher for longer.

As inflation rises or falls, so will interest rates.

Inflation is still the primary obstacle to cutting interest rates. Core inflation readings, which don't include volatile food and energy prices, remain stubbornly high. That said, heavy U.S. Treasury issuance in the wake of the debt ceiling agreement, a shrinking money supply, and credit tightening following recent bank failures could combine to severely reduce liquidity. If these factors were to destabilize the economy, it could cause the Fed to lower rates in response.

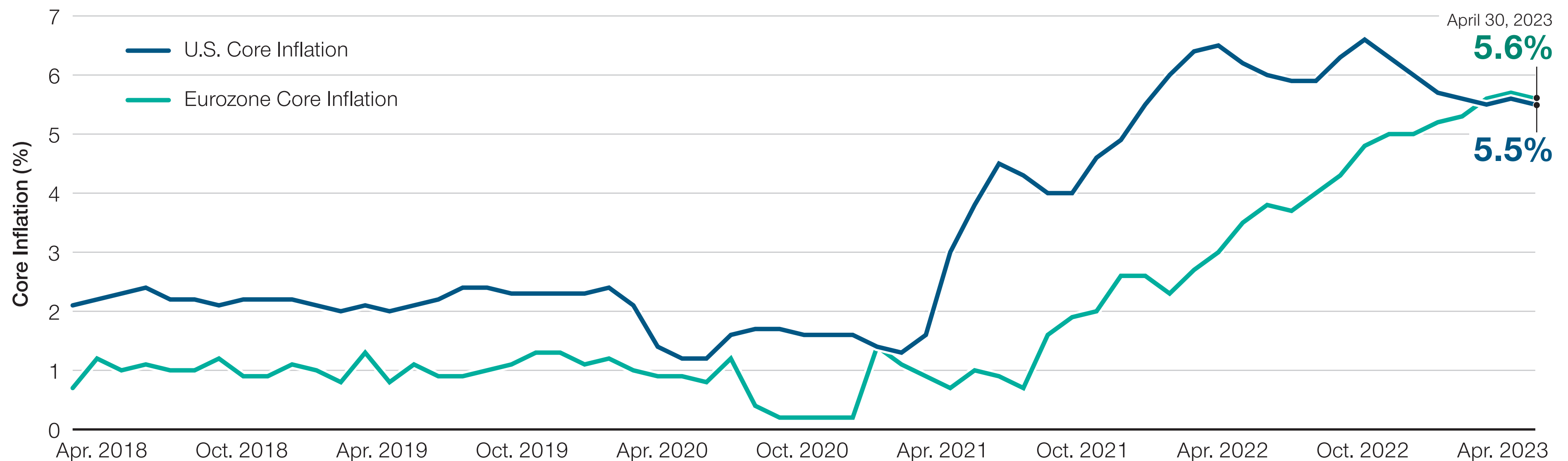
Momentum is shifting abroad too.

Beyond the U.S., other major economies proved surprisingly resilient in the first half—helped along by falling energy prices, China lifting COVID restrictions faster than expected, and a weak yen that boosted Japan's export sector. However, much of that momentum has now faded (though Japan's outlook is more positive). In addition, structural and cyclical factors both appear likely to curb U.S. dollar strength over the intermediate term, favoring other currencies.

> I do think the Fed and other central banks will cut rates eventually. But the timing is tricky.
>
> **Arif Husain**
> Head of International Fixed Income and CIO

Core Inflation Remains Stubbornly High

CONSUMER PRICES LESS FOOD AND ENERGY, YEAR-OVER-YEAR CHANGE (AS OF APRIL 30, 2023)



Source: Bloomberg Finance L.P.

FIXED INCOME

Bonds Are Back?

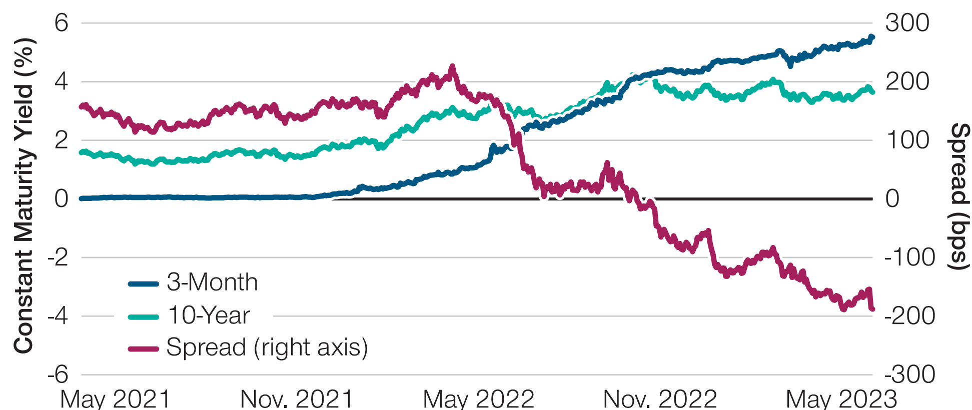
Don’t jump in with both feet yet.

The sharp rise in bond yields since early 2022 has improved return potential in many fixed income sectors. But, with an inverted U.S. Treasury yield curve, any aggressive move to buy longer-term bonds may still be premature. Yields on most sovereign bonds and investment-grade credits still aren’t positive after accounting for inflation, and trading money market holdings for longer-term bonds could result in a heavy return penalty.

However, for investors worried about a recession, modestly extending duration could help guard against a growth shock, potentially enhancing returns if a shock pushes yields sharply lower.

Inverted Yield Curve Means Fixed Income Investors Should Be Cautious

TREASURY YIELD CURVE: 10-YEAR MINUS 3-MONTH CONSTANT MATURITY (AS OF MAY 31, 2023)



Source: Federal Reserve Bank of St. Louis.
Duration can measure how long it takes, in years, for an investor to be repaid a bond’s price by the bond’s total cash flows. It can also measure a bond’s price sensitivity to changes in interest rates.
The bond spread or yield spread, refers to the difference in the yield on two different bonds or two classes of bonds. Investors use the spread as in indication of the relative pricing or valuation of a bond.

High on high yield.

The rise in yields may have created opportunities in corporate credit. Yields in the 8%–10% range and credit spreads close to their 10-year average make the global high yield market attractive in any scenario short of a deep global recession.

Slower economic growth and higher rates are likely to push default rates up gradually from now into 2024. But with corporate balance sheets still healthy on average, default risks appear moderate. Bottom-up research and skilled security selection will be critical to managing default risk.

Increasing appeal of global fixed income.

For investors in markets with inverted yield curves (like the U.S.), other global bond markets may offer attractive diversification and potential return opportunities. But global investors should also be mindful of "black swan" risks—potentially high-impact events with probabilities that are difficult to estimate.

Three "black swans" to watch for:

A change in Japan's monetary policies could entice the country's domestic investors to reinvest back home, potentially destabilizing global markets.

A **U.S. liquidity crunch** could cause a broader systemic market event.

The **"shadow" banking system** of less regulated, nonbank lenders has yet to be tested across a full economic cycle.

Selective Opportunities in Global Credit Sectors

INVESTMENT-GRADE AND HIGH YIELD SPREADS, IN BASIS POINTS (AS OF MAY 31, 2023)

Global high yield = J.P. Morgan Global High Yield Index. Global investment grade = Bloomberg Global Aggregate Corporate Index. Spreads versus sovereign bonds with similar duration.
Sources: J.P. Morgan Chase (see Additional Disclosures), Bloomberg Finance L.P. T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved.

EQUITIES

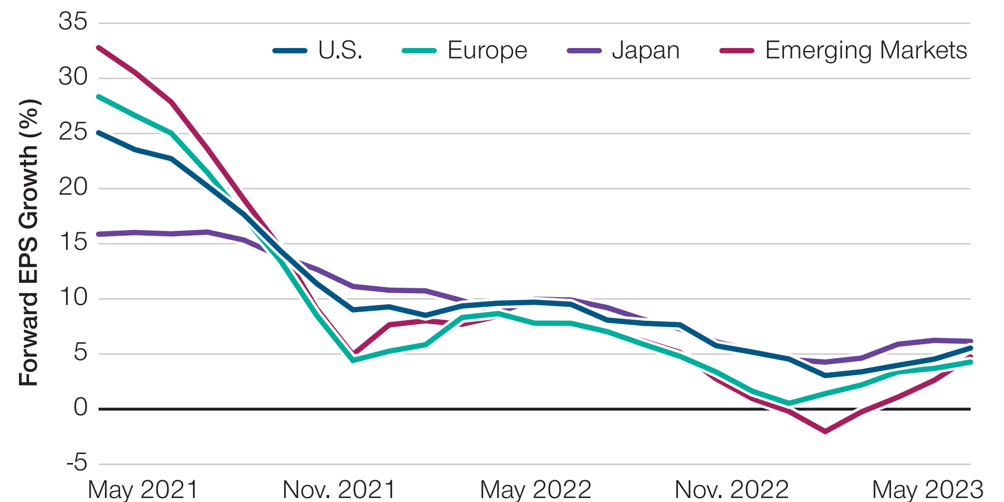
A Focus on Earnings

What's ahead after a surprising start to 2023?

Key global equity markets delivered positive returns in the first five months of 2023. Going forward, the question remains whether earnings forecasts, which have stabilized so far in 2023, will turn down again. If the economy enters a mild recession, we believe that 2024 earnings could range from flat to down 5%. Compared with past earnings cycles, that could be viewed as a bullish outcome. But even a modest earnings decline would put further pressure on U.S. large-cap valuations, which still appear stretched.

Expectations Have Fallen, but Earnings May End Up Lower Than Forecast

FORWARD EARNINGS PER SHARE (EPS) GROWTH ESTIMATES, NEXT 12 MONTHS (AS OF MAY 31, 2023)



U.S. = S&P 500 Index. Europe = MSCI Europe Index. Japan = MSCI Japan Index. Emerging Markets = MSCI Emerging Markets Index.
Sources: T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved. Standard & Poor's, MSCI (see Additional Disclosures).

Looking outside the U.S. large-cap space.

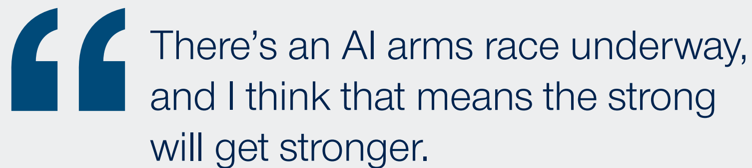
By some measures, U.S. large-cap stocks appear more expensive than they did before last year's bear market, even though the price/earnings ratio on the S&P 500 Index has fallen. Relative to bonds, current S&P 500 valuations are among the least attractive they've been in the last 10 years.

There are, however, bargains to be found in quality small- and mid-cap stocks, which are trading at significant discounts to their historical averages. Small-cap valuations have historically been more vulnerable during economic downturns, but skilled active managers can avoid companies with weak balance sheets and high cyclical earnings exposure.

Potential opportunities also may be available at the opposite end of the capitalization spectrum. Mega-cap technology companies rebounded strongly in the first half of 2023, in part because of enthusiasm for artificial intelligence (AI) applications such as ChatGPT.

AI should continue to drive investment in a range of tech sectors, including semiconductors, memory, and cloud storage. AI programs also require expensive training. All this plays to the strengths of the largest tech platform companies, which have the resources to develop new AI applications or refine existing ones.

For global equities more broadly, a key question for the second half is whether a record-long run of U.S. stock market outperformance will finally end. Developed international equities, as a group, already are catching up with the U.S., especially Japanese equities.



> There's an AI arms race underway, and I think that means the strong will get stronger.
>
> **Justin Thomson,**
> Head of International Equity and CIO

Investment Implications

MACRO

Economic Resilience Tested

Maintain Flexibility and Keep "Dry Powder"

Global economies have been surprisingly resilient so far in 2023 but aren't out of the woods yet. With short-term yields at attractive levels and economic uncertainty high, it makes sense to consider shorter duration bonds.

Strategies to Consider:

Global Unconstrained Bond

Unconstrained Credit

FIXED INCOME

Bonds Are Back?

Take Advantage of Attractive Yields

Bonds may not be a good source of capital appreciation in 2023, but they may provide yield. Equity upside may be limited by an uncertain economic landscape, so high yield bonds may offer better return opportunities.

Strategies to Consider:

Emerging Markets Bond

Emerging Markets Corporate Bond

Global Multi Sector Bond

Global High Income

EQUITIES

A Focus on Earnings

Equity Markets With Unique Profiles

U.S. small-caps offer attractive valuations. Structural changes in corporate policies could be a long-term tailwind for Japanese equities. Mega-cap technology companies are well positioned to benefit from artificial intelligence.

Strategies to Consider:

Global Focused Growth

Global Growth Equity

International Disciplined

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

Additional Disclosures:

Bloomberg PORT – Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

J.P. Morgan Chase – 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 © 2023, J.P. Morgan Chase & Co. All rights reserved.

MSCI – 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.

S&P – Copyright © 2023, S&P Global Market Intelligence (and its affiliates, as applicable). Reproduction of (S&P 500 Index) in any form is prohibited except with the prior written permission of S&P Global Market Intelligence ("S&P"). None of S&P, its affiliates or their suppliers guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions, regardless of the cause or for the results obtained from the use of such information. In no event shall S&P, its affiliates or any of their suppliers 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 S&P information.

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 noted on the material 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.

Risk Considerations:

All investments involve risk, including possible loss of principal.

Small-cap stocks have generally been more volatile in price than the large-cap stocks.

International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in emerging markets.

Fixed income investing includes interest rate risk and credit risk. When interest rates rise, bond values generally fall. Investments in high yield bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt.

Investing in technology stocks entails specific risks, including the potential for wide variations in performance and usually wide price swings, up and down. Technology companies can be affected by, among other things, intense competition, government regulation, earnings disappointments, dependency on patent protection, and rapid obsolescence of products and services due to technological innovations or changing consumer preferences.

Diversification cannot assure a profit or protect against loss in a declining market.

Although actively managed investments have the potential to outperform an index, this is not guaranteed, and they may trail the index. There is no assurance that any investment objective will be achieved.

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.

© 2023 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.

For Accredited Investors Only. Not For Further Distribution.

My takeaway fits in a fortune cookie:
Stay invested; stay diversified.

Sébastien Page
Head of Global Multi-Asset and CIO

Find out how to decipher confusing market indicators
at **troweprice.com/getinsights**

CCON0153106
202306-2962483