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Q&A with Scott Berg
WHAT HAS DEFINED THIS BULL MARKET, AND HOW WILL IT PLAY OUT?

KEY POINTS

- We are in the midst of one of the strongest runs for equity markets in history, but although this bull market may be mature, there are reasons to remain encouraged.
- Secular changes in the world should mean that inflation remains in control, and therefore monetary tightening should remain gradual. This has historically provided a good environment for equity returns.
- Our positions are driven by our fundamental and stock-specific views. We remain excited by many areas of the market where investors can continue to benefit from change and disruption.
- Overall, we remain constructive and see enough drivers in place to provide support to equity markets, even at these more elevated levels.

Q You have now been managing the T. Rowe Price Global Growth Equity Strategy for over nine years now. Global equity markets have performed well in that time. How has it been investing through this period?

Well, we are currently enjoying one of the strongest bull markets of all time, but it hasn't felt like that for us as investors. Over the course of what seems like an eternity since this bull was born in March 2009 (taking the S&P's low point), we have certainly climbed a mighty wall of worry.

Naturally, the scars incurred during the financial crisis have been slow to heal, but confusion has also reigned for much of this time. This is no surprise given policymakers have been forced to employ radical measures (quantitative easing (QE), record low interest rates) to deal with both an absence of economic growth, and the perpetual threat of "crisis 2.0". With economic conditions impacting and changing society outside of equity markets, the net result has been an ongoing lack of comfort and few warm hearts towards this "Aging Bull". An unusual perspective considering many markets are at all-time highs.

Q What has driven many equity markets to these new highs and is it merited?

The depth of the global financial crisis has been partly the cause, with very cheap valuations providing an anchor for the majority of returns to date. It is also the global financial crisis, and the subsequent length and breadth of monetary policy response, that has stoked equity market returns for so long.

More recently, the run has been extended by rather non-dramatic factors of stability and gentle improvement. Global growth has been modest, but trending upwards and the political backdrop (North Korea aside) has been less extreme in nature,

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versus worst case scenarios. Most important, corporate earnings, which have been poor, have been trending upwards and broadly so, acting as a fundamental underpin to rising investor expectations. In addition, there remain many expensive alternatives to equities, leaving them looking attractive on both a fundamental and relative basis.

Q So you don't currently see a bubble in equity valuations?

After such a strong run it is easy to see why investors are asking that question. As fundamental investors, however, we look at the indicators that have the highest degree of visibility and the most impact upon long term equity returns; here valuations and earnings remain at the forefront of our mind.

Although this bull market may be mature, the majority of equity valuations remain reasonable if you believe as we do that we are in a stable-to-improving growth environment. Indeed, history suggests that investors are happy to pay a premium for equities (versus long-term averages) when in such an environment.

This bull market will of course end at some point. However, it is unlikely to be old-age alone that causes the bull to die. Bull markets tend to end due to crisis (2007) or valuation extremes (2000), and while some segments of the market have established premium valuations, it's certainly not the case that we are witnessing valuation extremes on a broad basis.

Q Will rising interest rates be the catalyst to end this bull market?

In some respects, a sharp tightening of monetary policy via a meaningful increase in interest rates could very well create challenges for the global economy and global equity markets. Leverage has increased steadily in many segments of the global economy and it's unlikely that all debt-holders are ready for a sharp tightening of policy.

However, just as many pundits have dusted off their late cycle playbooks to position for a rate hike cycle and bears have cried "credit crisis 2.0", rising inflation trends of late 2016 and early 2017 now appear to have stalled. This is a positive for the bulls given it may stop an aggressive tightening of monetary conditions.

Importantly, we believe the reasons why inflation is likely to remain subdued are broad-based, secular in nature and could have potentially wide ranging consequences for investors. While there are material long term implications if we are right, near term, the impact has been to adjust expectations around when interest rates may rise and by how much, with the consequence of adding more gentle fuel to the equity market fire.

Q The environment seems more complicated than ever. How are you tackling this in your strategy?

Indeed, and because of this we look to have a balanced portfolio to help us to achieve the best possible results for our investors. On a regional basis, we expect U.S. companies to extend their positive trends in earnings growth. Meanwhile, in Europe, economic growth is expected to gradually improve, supported by resilient household consumption, improving business sentiment and stronger global trade.

We have a large exposure to emerging markets, but our focus is largely concentrated in China, India, Indonesia, Philippines and Peru. These countries have strong long-term growth prospects driven by domestic consumption trends, as well as favourable demographics that can spur ongoing growth in what remains a low to moderate growth world. This could provide an economic and earnings advantage over the long term, an advantage that we do not believe equity markets have priced in today.

It is important to say, however, that we do not invest along regional or country lines. Instead, we look at markets from a bottom-up perspective, and our positioning is driven primarily by fundamental, stock-specific views. One theme we continue to embrace is to own those stocks on the right side of the changes we are seeing today, the disruptors taking market share from rivals. This has been a profitable exercise in recent years and at the right price will continue to be a source of opportunity for forward looking investors.

Conveniently, segments defined by change and disruption (Consumer Discretionary, Technology especially) also lend themselves to active management, with the benefits to winners over losers dramatically more pronounced than in segments of the market where change is less dramatic (Consumer Staples, Utilities and Telecom's).

Q What is the outlook going forward, and how should investors be positioned?

Today, anxiety remains even despite renewed equity market strength. While understandable, we remain constructive that there are enough drivers in place to maintain and elevate markets levels, albeit over a new and hence, uncertain phase of this equity cycle. It is also important to recognize that change, innovation, and improvement have occurred in spite of fears that a new normal environment signalled a peak for global economies.

Between valuation extremes, markets are more likely to be data dependent with respect to whether economic activity is accelerating or decelerating, and how corporates are being impacted by these trends at an earnings level. On these measurements, the data is implying a reasonably good setup for fundamental improvement over the medium term.

Secular changes in the world should mean that inflation is likely to stay low, and interest rates may not move as high as the late stage economic historians/textbooks would state. Economic growth will also remain more subdued, but that is good for me as a "growth" manager. It is good for my style, good for my exposure to the stronger levels of growth in emerging markets, and good for the companies I am investing in that are disrupting their markets. Encouragingly, markets have reflected this in 2017, and so far in 2018, giving me the opportunity to enjoy strong returns so far.

The key question is will this materially change. Will something cause U.S. growth, inflation, interest rates or the U.S. Dollar to move again? Currently, we cannot see the driver, so we remain comfortable in emerging markets and the growth areas of the market. Geopolitics can of course disrupt markets, but I can't call a crisis better than anyone else, so that remains difficult to predict. We do, however, constantly look for potential crises that could disrupt markets. We use our deep research platform which includes fixed income colleagues who are pretty good at identifying potential threats.

FIGURE 1: Things that didn't exist in March 2009

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Q Any final message for investors?

While we will continue to face many complexities, I remain cautiously optimistic that the aging bull is not on its last legs. While slower economic growth has become the new normal, it is growth nonetheless. Most encouraging, employment data continues to be solid to strong on a global basis.

Ultimately, earnings delivery will be crucial to returns in the next stage of this equity cycle, given expectations have been rising alongside valuations. This may result in some near-term volatility, but if this does transpire, it should not be confused with the end of this bull market. One way or another, the unknowns of the cycle will mean that for me as an investor, I will be offered opportunities to refresh the portfolio on weakness at some stage, before this bull market eventually ends.

The fundamental backdrop is therefore reasonably solid when considering the potential for global equities to hold their ground or deliver more, albeit more modest returns. I will continue to actively search for durable companies where we may see the best opportunities for growth and improving returns. That is the best way I can deliver potential returns for my clients.

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