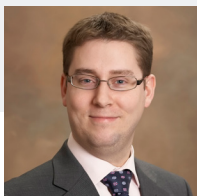




**PRICE
POINT®**

September 2018

In-depth analysis and insights
to inform your decision-making.



Ben Griffiths
*Portfolio Manager, European Smaller
Companies Equity Strategy*

European Smaller Companies **ENDURING APPEAL DESPITE EXTENDED BULL MARKET**

KEY POINTS

- While European smaller companies have enjoyed almost a decade of strong performance, the asset class retains its appeal.
- The European small-cap universe is broad and deep, with an enviable opportunity set of investable company names.
- Small-caps embrace a greater breadth of industries relative to their large-cap counterparts, alongside a greater dispersion of returns.
- Within the European small-cap universe, we believe our extensive proprietary research represents a strong competitive advantage compared with the limited research coverage by others in this segment.

European smaller companies have enjoyed almost a decade of strong performance since the post-financial crisis troughs, both in an absolute sense and relative to larger companies. Yet I remain excited about the enduring appeal of the asset class. While aggregate valuations have moved higher, on a day-to-day basis we continue to discover many attractive opportunities as the team travels across the continent to meet with companies. I am constantly reminded about the scale of the inefficiencies that we can potentially exploit and the breadth of opportunity that we are presented with.

Our fundamental research approach has been applied in Europe and other markets outside the U.S. for nearly three decades, and for appreciably longer in the U.S. Its relevance—and the potential rewards—remains as valid now as it

has ever been. In future articles we will further examine key European small-caps themes.

THE THREE CORE ATTRIBUTES OF EUROPEAN SMALLER COMPANIES

Looking beyond the equity market's current extended bull-run, three key features of the European smaller companies asset class contribute to a more enduring appeal for investors:

1. A broad and deep investment universe
2. Exploitable pricing anomalies, under-explored by other investors or sell side research
3. A wide dispersion of returns

These features are particularly attractive to well-resourced investment managers and make the asset class a fertile territory for identifying potential

opportunities. I expand on each of these points below:

A broad and deep investment universe

The European small-cap universe has an enviable opportunity set of investable company names. The universe encompasses a wide expanse of industries, particularly those at the cutting edge of innovation where growth rates tend to be high.

What I find particularly compelling about this area of the market is that smaller companies offer real opportunity to access potentially high growth rates that are not easily available elsewhere.

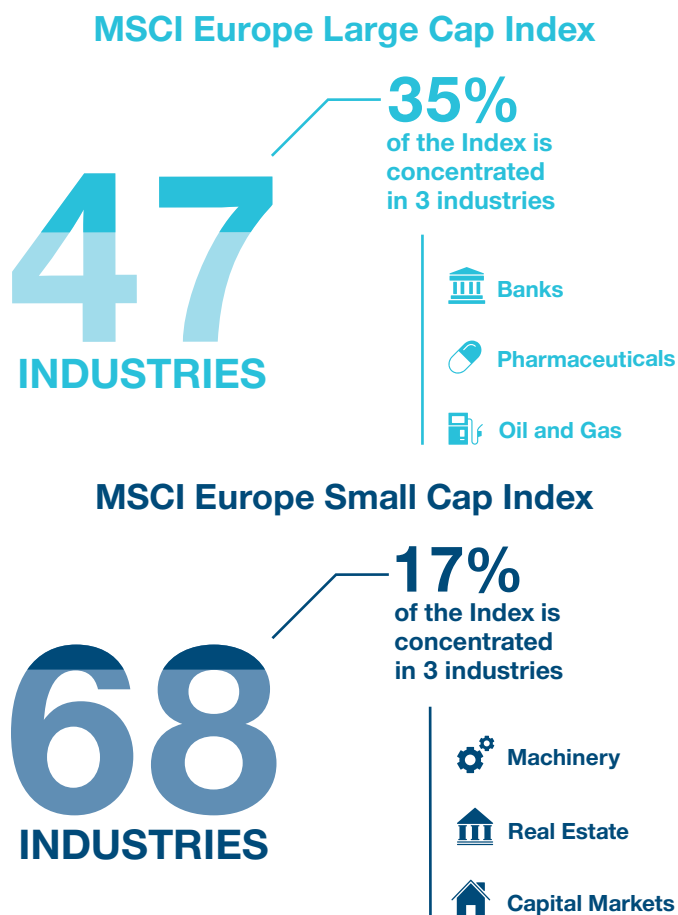
Although both European and U.S. markets are dominated by large-caps in terms of market capitalization—only 12% of the U.S. equity universe has a market cap of less than €5 billion¹ compared with 18% in Europe—the opportunity set is relatively limited in comparison to small-caps. The number of small-caps, defined as companies with a market capitalization of between €50 million and €1 billion, account for 64% of the European equity market compared with 52% in the U.S.²

Small-caps on both sides of the Atlantic also embrace a greater breadth of industries relative to their large-cap counterparts, which are skewed toward certain dominant industries. Figure 1 shows that European small-caps are much more diversified than their larger-company counterparts. Some 17% of industries in the European small-cap index are concentrated in 3 industries, whereas in the large-cap index, the figure is 35%.

Exploitable pricing anomalies

Small cap markets are also typically fragmented, poorly covered, and inefficient. As an active investor, this is an exciting juxtaposition—a large opportunity set but with limited coverage—as it tends to lead to pricing

FIGURE 1: Small-Caps Are More Widely Diversified Across Industries
As of August 31, 2018



Source: MSCI. 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.

anomalies that well-resourced, active managers can potentially exploit.

What's more, if anything, I see the frequency of pricing anomalies in this arena potentially rising over time. Counterparties continue to reduce the number of research analysts and the sectors and industries they cover. This is no short-term scenario but, rather, a long-term industry trend reflecting harsh industry economics. As such, the progressive reduction in the coverage of smaller companies is a trend that I can only see continuing.

Within Europe, I can take advantage of our proprietary research efforts, which we believe give us a strong competitive advantage when compared with the limited research coverage typically accorded to the small-cap arena by other investors and sell side research.

Figure 2 shows that dramatically fewer analysts follow smaller companies than larger companies. This pattern can be clearly seen in both Europe and the U.S. Significantly, the level of sell side research coverage in Europe has not only been under pressure in a relative

¹Source: FTSE Russell, Russell 1000 Index.

²Source: FTSE Russell, Russell 2000 Index.

Russell Investment Group is the source and owner of the trademarks, service marks, and copyrights related to the Russell indexes. Russell® is a trademark of Russell Investment Group.

sense compared with large-cap, but coverage at the smaller end of the market also appears to be declining in an absolute sense. This chimes with our direct experience, as we find that many of our counterparties are devoting fewer resources to the asset class. The early evidence from recent regulatory changes is that these pressures could well become even more intense.

Wider dispersion of returns in the small-cap universe

The small-cap universe offers a wide dispersion of returns compared with large-cap counterparts, which is also compelling (see Figure 3). For active managers this provides an opportunity to potentially capture greater returns in the small-cap space. Applying fundamental research we can establish an estimate of the intrinsic value of a security and then exploit the greater variability around this as sentiment and short-term non-fundamental factors temporarily exert their influence.

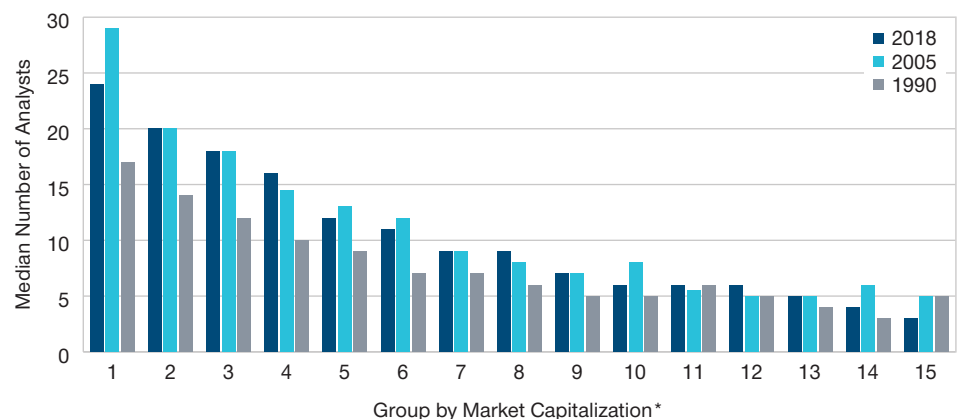
FUNDAMENTAL RESEARCH IDENTIFIES DURABLE GROWERS EARLY ON

An often overlooked or under-acknowledged feature of the European small-cap sector is the propensity for innovation. I have noticed that the market systematically underestimates the scope for small and innovative companies to sustain high rates of growth and to be much larger in five to 10 years. This can be pronounced for companies with appreciable runways for durable growth, particularly where innovation has generated significant “undiscounted change.” As a result, underlying returns can be quite polarized, so there is a pressing need for an active stock-picking approach.

My team aims to discover at an early stage those small and innovative companies that can become much larger over the longer term and to hold them for a multi-year period. Consequently, our investors should benefit from powerful compounding that arises from sustained earnings growth. The impact of the rerating of the company by the market, as appreciation of its

FIGURE 2: The Number Of Analysts Covering Small-Caps Has Been Declining

As of August 31, 2018



*The market capitalization groups consist of the top 1,500 stocks in the European universe, ordered by market capitalization and split into buckets with an equal number of stocks in each. Group 1 has the highest market capitalization range, and group 15 has the lowest.

Source: T. Rowe Price calculations based on IDC and Thomson Reuters (IBES/Worldscope).

FIGURE 3: Europe Small-Caps Can Earn Much Higher Returns vs. Large-Caps

As of August 31, 2018



*The returns are taken from all the individual stock returns from the index and then put into percentiles. Most returns lie between the 5th and 95th percentiles; we do not include anomalies at the extremes to avoid skewing the data. Indexes used: MSCI Europe Large-Cap Index for large-caps and MSCI Europe Small-Cap Index for small-caps.

Source: T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved.

characteristics and potential take hold, can also be significant.

At T. Rowe Price, information advantage is at the heart of our investment approach. Accordingly, we have invested heavily in research personnel and resources in keeping with this singular ambition. Rigorous fundamental analysis—undertaken by a dedicated European small-cap team, backed by a well-resourced global research platform of 130 equity analysts—is the bedrock of my decision-making process.

At the same time, we are not short-term investors. Unlike some small-cap investors, I am not looking to make an overnight profit. By taking a longer-term investment view, I can dedicate the time needed to research this broad and exciting universe to identify pricing anomalies and find quality, durable growth opportunities. I’m not necessarily looking for off-the-chart growth either. It is the persistence of the growth, compounded over time, that is important.

Key Risks—The following risks are materially relevant to the strategy highlighted in this material: Transactions in securities of foreign currencies may be subject to fluctuations of exchange rates which may affect the value of an investment. Investment in small companies involves greater risk than is customarily associated with larger companies, since small companies often have limited product lines, markets or financial resources.

INVEST WITH CONFIDENCE®

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

To learn more, please visit troweprice.com.

Important Information

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **Past performance is not a reliable indicator of future performance.** The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA—Issued in the European Economic Area by T. Rowe Price International Ltd, 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

New Zealand—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Singapore—Issued in Singapore by T. Rowe Price Singapore Private Ltd., No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Ltd. is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

USA—Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

© 2018 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.