



**PRICE
POINT®**

September 2018

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

Global Equities **TAKING A VIGILANT APPROACH TO RISING TRADE TENSIONS**

KEY POINTS

- T. Rowe Price managers are carefully assessing how trade tensions may impact various sectors and companies but have made only modest portfolio changes.
 - New trade policies are not likely to derail the U.S. economic expansion, but market risks have increased.
 - China's government is expected to continue supporting the economy if tariffs hamper growth.
 - Threatened tariffs on autos and auto parts could be devastating for that industry.
-

The Trump administration's aggressive efforts to extract more favorable terms for existing trade agreements have raised concerns about the potential disruption of global supply chains, higher prices for businesses and consumers, and slower global growth.

These challenges to global trade pacts have prompted T. Rowe Price portfolio managers to closely monitor trade discussions to assess potential impacts on sectors and companies. Some managers have modulated some portfolio positions given heightened risks, but as of the end of September, they generally had not made significant adjustments—due to the uncertainty surrounding the trade negotiations.

Managers believe the new trade policies are not likely to derail the U.S. economic expansion, which has seen U.S. equity markets reach new highs this year, but they believe market risks have increased.

NEW TARIFFS

As of the end of September, President Trump had imposed tariffs of USD \$250 billion on a wide range of imported goods from China, prompting retaliation from the world's second-largest economy and the United States' largest trading partner. He also was considering tariffs on an additional USD \$267 billion of Chinese imports, which would cover almost all of China's exports to the United States.

In turn, China added tariffs on USD \$60 billion of U.S. exports to China, putting its total tariffs on USD \$110 billion worth of goods. Last year, China imported USD \$130 billion of goods from the United States.

In March, the United States also imposed 25% tariffs on steel imports and 10% tariffs on aluminum imports from various areas, including the European Union, Canada, and Mexico, as well as on various consumer and industrial products—prompting global retaliation.

Construction accounts for about 48% of U.S. steel consumption, and autos account for 29%. If passed on, the steel and aluminum tariffs could raise prices in the United States and abroad for a wide range of other manufactured goods, including other types of vehicles, beverages, and kitchen appliances.

Meanwhile, the Trump administration has reached a temporary truce with the European Union and a revised North American Free Trade Agreement (NAFTA) with Mexico and Canada that is expected to relieve pressure on the auto industry supply chain in North America.

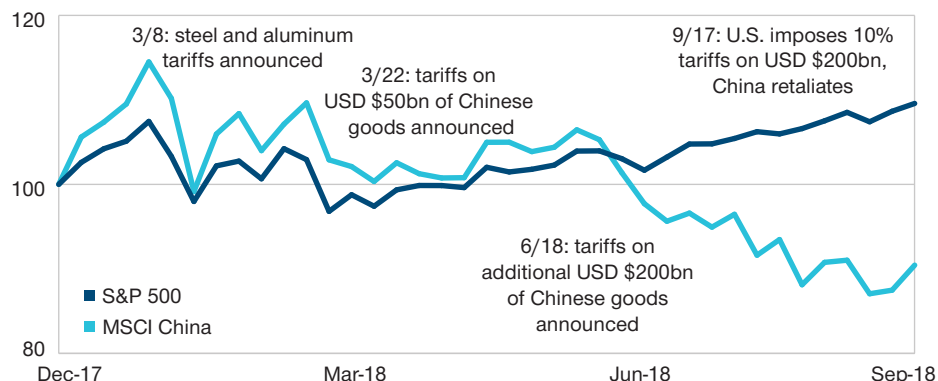
The revised NAFTA agreement would require automobile companies to manufacture at least 75% of an automobile's content in North America, up from 62.5% currently, to qualify for NAFTA's zero tariffs. But congressional approval remains uncertain.

David Giroux, chief investment officer of U.S. Equity and manager of the US Capital Appreciation Strategy, says that four groups of companies may be affected by the tougher U.S. trade policies:

- U.S. and foreign importers and exporters directly penalized by U.S. or retaliatory tariffs, such as U.S. agricultural exporters to China
- U.S. companies exposed to non-tariff retaliation by China if a trade war escalates, such as multinational companies with business in China that are large U.S. employers and have political influence—notably, Apple, General Motors, or McDonald's. Retaliation might include boycotts or legal and regulatory actions
- U.S. companies that do business in China and that don't have a lot of foreign competitors or political influence and so have less risk—unless U.S. tariffs cause the Chinese economy to suffer

FIGURE 1: U.S. and China Equity Market Performance in Year of Rising Trade Tensions

Relative Price Performance in 2018 indexed to 100 as of December 31, 2017
As of September 24, 2018



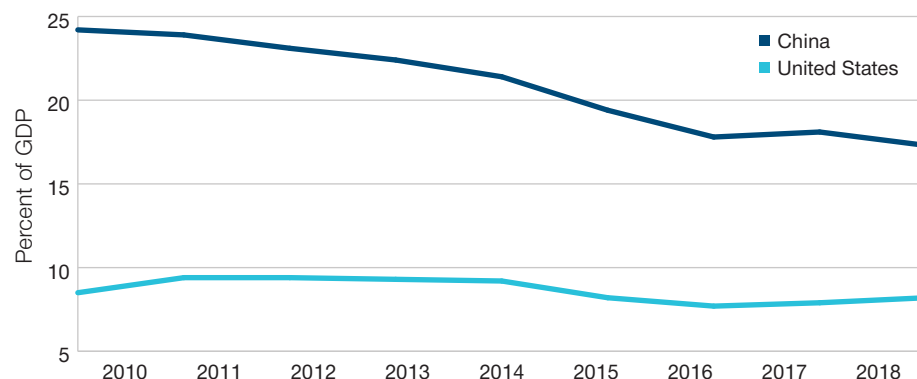
Past performance is not a reliable indicator of future performance.

Trade restrictions have had more impact in China. However, the recent drawdown in Chinese equities is as much a reflection of slowing domestic growth rates as it is the trade wars.

Sources: Goldman Sachs Investment Strategy Group, Bloomberg, and FactSet.

FIGURE 2: China and U.S. Exports as GDP* Share

As of June 30, 2018



Sources: China National Bureau of Statistics, U.S. Bureau of Economic Analysis, Haver Analytics, and T. Rowe Price.

*Gross domestic product.

- Sectors and companies that could benefit if trade tensions escalate because they might be viewed as defensive investments, such as U.S. utilities; “They don’t have any operations in China, and if the economy here slows, that could mean lower interest rates, which is good for utilities,” Mr. Giroux says

INVESTMENT IMPACT

Larry Puglia, manager of the US Large-Cap Core Growth Equity Strategy, is encouraged by the agreements in

progress with the European Union and Mexico and Canada. “Pursuing fairer trade terms is desirable but entails certain risks,” he says. “It would be premature to make investment decisions that assume successful resolution of these issues. We’re doing the math to determine what’s at stake.”

Over decades, large U.S. companies, particularly manufacturers, have developed extensive global supply chains, relying on worldwide sources of lower-cost production. Higher

component costs due to tariffs could bring higher inflation over the long term, says Peter Bates, manager of a global industrials strategy. “But companies would eventually learn how to maximize their returns under the new rules.

“Tariffs undermine globalization, and the potential downside of being less globalized is higher prices, but that could lead to less reliance on foreign labor and more production being brought back to the United States,” he says. As a result, Mr. Bates is focusing on companies that sell valuable products “that aren’t commodities—as they can raise prices to offset higher costs.”

U.S. steel companies U.S. Steel, AK Steel, and Steel Dynamics have benefited from the 25% tariff on steel imports. Bradlee Kilgore, the firm’s steel analyst, says tariffs have increased U.S. steel prices from USD \$600 to USD \$900 a ton this year. Imports have dropped from 25% of the U.S. market at the start of this year to about 15% to 20%.

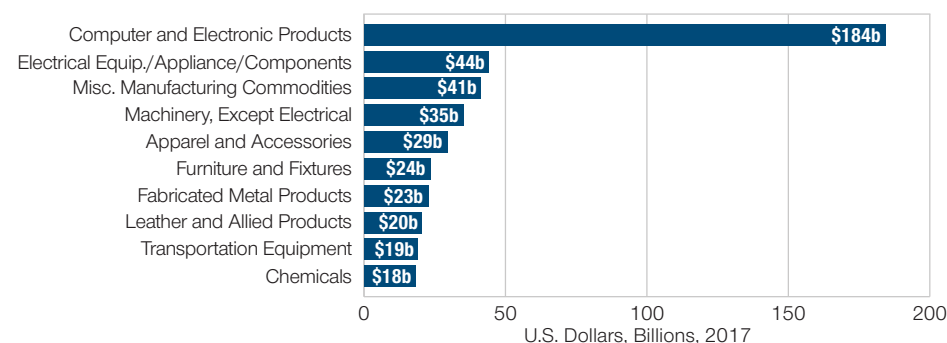
While a short-term boon, tariffs “longer term could do more harm than good because they might exacerbate the eventual downcycle,” Mr. Kilgore says.

If tariff-driven price increases lead to a U.S. economic slowdown, stocks in discretionary consumer sectors, such as clothing and leisure travel, could underperform, but those in more defensive areas, such as food, likely would be less exposed, says Jason Nogueira, manager of a global consumer strategy. He recently has increased his exposure to stocks of certain discretionary companies that could be more resilient in a slowdown.

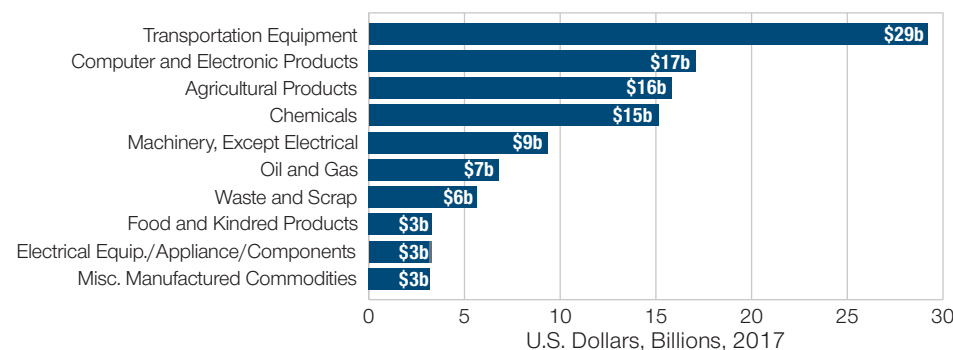
“The reality is if all the proposed tariffs go through, that would be fairly negative for the economy and the markets,” Mr. Nogueira adds. “Just about every company has global supply chains that could be affected—plus there would be secondary and tertiary effects. It’s very difficult to calculate all the possible permutations and consequences.”

FIGURE 3: Top Ten Categories of U.S. Imports From and Exports to China

Top U.S. Imports: Computer/Electrical Products



Top U.S. Exports: Transportation Equipment



Sources: U.S. Census Bureau and T. Rowe Price.

GLOBAL IMPACT

Globally, managers say tariff concerns could slow spending on technology and adversely affect semiconductors because that sector is most reliant on global trade. Also, the auto industry—directly affected by tariffs—has become a key customer for semiconductor companies.

Ray Mills, manager of the International Core Equity Strategy, has reduced some auto positions. This includes European companies that export to China from the United States.

While the Japanese market generally has not suffered from tariff concerns, Japan is more correlated with global industrial production than other markets, so it is susceptible to adverse fallout from tariffs. Also, Japanese companies have moved much of their supply chains to China.

Emerging markets have been hit hard recently by concerns over global growth, rising interest rates, and a strong U.S. dollar but are less susceptible to U.S. tariffs than several years ago. The United States remains important for emerging markets, but they have increased trade with each other and are becoming less dependent on developed markets. However, increased tariffs could spur inflation, which could mean higher interest rates in the emerging world.

China would be more at risk than other emerging markets if trade tensions worsen, in our managers’ view, particularly in the computer and electronics industry, which accounts for almost half of U.S. imports from China. As a response to softer growth—expected to be exacerbated by trade concerns—China has been easing monetary and fiscal policies.

However, managers say China has enough flexibility to reach a trade settlement with the United States, and they believe China's government will continue supporting the economy if tariffs hamper economic growth.

Bond markets' key development this year has been the strengthening of the U.S. dollar, particularly against certain emerging market currencies. Uncertainty over tariffs may have played a role, but Federal Reserve tightening, while other central banks remain accommodative, and the relative strength of the U.S. economy have been more important factors, says Steven Huber, co-manager of the Global Multi-Sector Bond Strategy.

"Tariffs could have a short-term inflationary impact, but so far it's been modest because they are very targeted," he says. "Longer term, I think it will end up just being noise."

ECONOMIC IMPACT

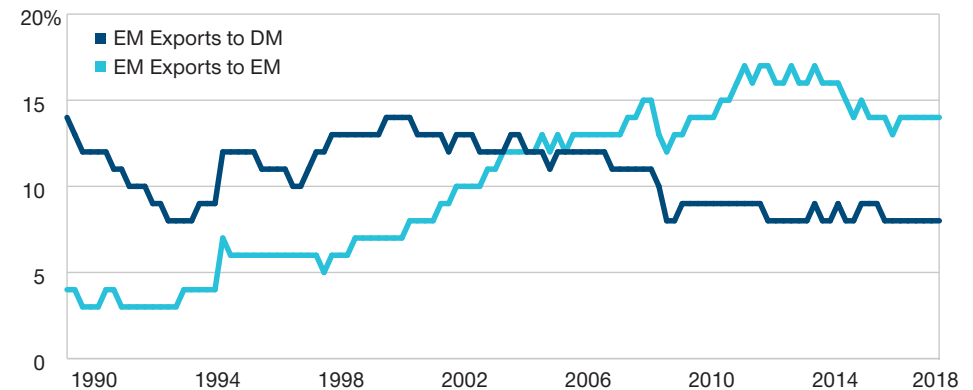
Alan Levenson, T. Rowe Price chief U.S. economist, says that while current tariffs are harming certain industries, he expects they will have "minor impact on overall U.S. growth this year and into next year against the backdrop of all the fiscal stimulus"—perhaps cutting gross domestic product (GDP) growth by 0.25% to 0.50%. He notes that exports of goods accounted for just 7.9% of U.S. GDP in 2017 (compared with 18.1% in China).

However, risks could rise substantially if President Trump follows through on threats to impose sweeping tariffs—as much as 25%—on autos and auto parts. "That could

FIGURE 4: Emerging Market Economies are Less Reliant on Trade with the Developed World

Emerging Markets Trade to Developed and Other Emerging Markets as a Percentage of Gross Domestic Product

March 1990 to March 2018



Sources: Haver and Goldman Sachs Global Investment Research.

cause a recession in the auto industry, and we don't know what forms China's retaliation could take," Mr. Levenson says. "There are no rules in this."

Auto tariffs—were they enacted—might not apply to imports from Mexico and Canada up to a certain quota under the new trade agreement awaiting approval. But given the global scope of the industry, the possibility of new tariffs creates a "tremendous amount of uncertainty and real risk for the sector," says Joel Grant, the firm's auto analyst.

He notes that the U.S. auto industry employs more than 7 million people. "If car volumes were to go down 15% to 20%, I could easily see 100,000 jobs being lost because of it," he says. "The economic impact could be so negative that it's hard to fathom."

U.S. stock markets, meanwhile, have recently hit new highs, largely brushing aside concerns of a trade war and focusing on strong fundamentals such as robust corporate earnings and the economy.

"Markets are betting that whenever you have these sorts of issues with possible draconian outcomes, cooler minds usually prevail," Mr. Nogueira says. "That's historically been the right bet, but I am worried that you could end up with a suboptimal outcome. The market is not pricing in the possibility of consumer prices going up broadly."

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

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

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.