



What Jitters Over Trade Indicate About Markets

The potential for further volatility emphasizes the need for selectivity.

August 2019

KEY INSIGHTS

- The recent spike in volatility amid rising concerns over U.S.-China trade relations indicated that the medium-term fate of markets will be heavily influenced by how the dispute is resolved.
 - A deterioration in relations between the two countries is likely to lead to further bouts of volatility—and possibly a more serious downturn.
 - “Timing” the market in this environment will be very difficult. Selectivity is more likely to deliver durable returns during difficult periods.
-

The recent bout of market agitation over fears of an escalating trade war provided a stark reminder of just how influential US-China relations are on the global economy. While support remains in place from continued positive corporate earnings growth and accommodative central banks, any worsening of the trade dispute could bring further bouts of turbulence, possibly leading to a more sustained correction. Attempting to time the markets in this environment will be very risky, meaning that investors will likely need to be highly selective if they are to successfully navigate the difficult period ahead.

U.S.-China Trade Tensions Blow Up Again

What a difference a few days can make. For much of the first half of this year, investors seemed assured that slowing global growth would be mitigated by accommodative monetary policies from the U.S., Europe, and emerging

markets. While trade tensions ebbed and flowed, the markets chose to believe that common sense would prevail and that a “muddle through” scenario would play out. Rising asset prices reflected this view.

That all changed at the beginning of August when U.S. President Donald Trump announced new tariffs and China swiftly responded by allowing the renminbi to depreciate, prompting accusations of currency manipulation from the U.S. The sudden deterioration in relations between the two countries caused markets to sell off dramatically before stabilizing partially after Beijing stepped in to steady the currency. Any complacency over the U.S.-China trade dispute was wiped out in a matter of days.

Subsequent twists and turns in this saga, including the imposition of new tariffs and a possible currency war, have the potential to disrupt markets with an immediate and direct impact.

“...twists and turns in this saga, including the imposition of new tariffs and a possible currency war, have the potential to disrupt markets with an immediate and direct impact.”

“...selectivity is key to tuning out short-term noise...”

“Given the pace at which things change in trade negotiations, it is likely markets will continue to react to headlines and tweets for a while,” says Andrew McCormick, head of Fixed Income. “We are no longer pricing in a rosy scenario.”

The depth and complexity of the U.S.-China trade dispute means that it is very difficult to predict how negotiations will progress from here. “There have always been two issues,” says Fixed Income Sovereign Analyst Chris Kushlis. “First, the narrow trade issue, and second, the longer-term, geo-strategic rivalry—and it has been very hard to keep those on separate tracks. For a while, it seemed as if it might be possible to craft a narrow trade deal with limited substance, but even that now seems unlikely.”

What President Trump does from here will likely depend on what he believes will best enable him to get reelected as president next year, Kushlis believes. “What serves President Trump better: striking a trade deal or positioning himself as a ‘trade warrior’ and hoping that Fed interest rate cuts bail him out?” he says. “The Chinese are likely to dig in—they will not want to reward any pressure tactics from Trump. Overall, this is not good for anybody. There are no winners—just relative losers.”

Lack of Consensus on Strength of Global Economy

The potential impact of a worsening U.S.-China trade dispute on markets depends largely on the underlying strength of the global economy. Here, views differ, reflecting the strength of

T. Rowe Price’s diversity of thought among its investment professionals.

Head of Global Multi-Asset Sebastien Page acknowledges that there are concerns that the current extended cycle is fragile, but he says he does not believe the conditions are in place for a severe downturn. “We recognize the fragility of an aging cycle,” he says, “but we don’t see major speculative imbalances that could trigger a crisis.”

Charles Shriver, co-head of the T. Rowe Price Asset Allocation Committee, agrees. He argues that while continued volatility can be expected, conditions remain supportive. “The monetary policy environment is supportive, with the recent Fed rate cut and the likelihood of further action to offset weak growth, trade uncertainty, and tighter financial conditions,” Shriver says.

Other portfolio managers, particularly those in fixed income, are more cautious. Quentin Fitzsimmons, senior portfolio manager in the Fixed Income Division, believes that a breakdown in talks could push a fragile global economy over the edge. “I believe that the current situation has the ingredients of a full-blown international crisis,” he says. “There is a confluence of factors—U.S. politics, Chinese politics, the global economic cycle, the rise of populism, and the impact of technological change on key industries. All of these have been around for a while, but they seem to be coming to a head at the same time.”

“I see parallels with 2007, just before the global financial crisis struck.”

Maintaining a Long-Term Strategic Approach

When uncertainty is elevated, timing the markets—always a risky endeavor—becomes virtually impossible. At T. Rowe Price, we believe that selectivity is key to tuning out short-term noise in favor of durable, consistent returns. Our portfolio managers average 22 years in the industry and 17 years with T. Rowe Price, so they've weathered all kinds of markets. We've learned that volatile periods are often the time to buy good businesses at attractive valuations.

Against that backdrop, here are some notable trends we're observing:

Health Care

“Concerns over a possible “Medicare for All” system and drug price regulation have weighed down many health care shares. Yet, shares in many of the most innovative companies have performed well in recent months. Drug innovation appears to be accelerating—in our eyes, companies producing leading-edge therapeutics and medical devices offer some of the market's most attractive growth areas.

—Ziad Bakri,
Portfolio Manager,
Health Sciences Equity

Global Equities: Growth Cyclical

“Global investors are afraid and have crowded into stocks with low earnings volatility. High-quality, long-term growth assets with cyclical and perceived “risky” characteristics are priced for fear. Yet, to us, the world still looks much more like a “slow growth” and “low inflation” environment than a global crisis. If rates stay low while modestly positive growth persists, stocks should trade at higher multiples based on the equity risk premium—it is just math.

—David Eiswert,
Portfolio Manager,
Global Focused Growth Equity

European Corporate Bonds

“We currently see opportunities in eurozone corporate debt as the European Central Bank (ECB) could restart quantitative easing involving corporate bond purchases. The positive technical conditions generated by the ECB's potential return to the market more than offset the negative drag from weak fundamentals.

—Steven Boothe,
Head of Investment-Grade Credit

Emerging Markets

“We believe investors need to cast aside any preconceptions of emerging markets (EM) being a single investment opportunity and take the time to look at individual EM regions and sectors to find attractive investments. A number of EM economies boast a growing middle class that is underpinning domestic demand. Consequently, EM is no longer just an export-driven investment reliant on developed markets, or even Chinese, economic growth. EM credit is on a strong footing. Corporate fundamentals remain favorable despite a difficult 2018. Growth concerns in key global markets could also become tailwinds as central banks appear to be shifting to more accommodative policies.

—Ernest Yeung,
Portfolio Manager,
Emerging Markets
Discovery Equity

—Ben Robins,
Portfolio Specialist,
Emerging Markets Bond

Secular Disruption

“The secular forces powering the technology sector are robust and here to stay. The pace of innovation remains breathless. The expansion of media platforms, the rise of artificial intelligence and machine learning, and the potential of the cloud remain powerful forces at many different levels. However, investors should approach technology less as a standalone sector, but in a more diverse way.

—Scott Berg,
Portfolio Manager,
Global Growth Equity

WHAT WE'RE WATCHING NEXT

The unpredictable nature of the U.S.-China trade dispute means that it is difficult to predict when the next developments will occur, but we will be monitoring this situation very closely for the foreseeable future. U.S. President Donald Trump's next move should tell us something about his long-term objective: Will he tone down the rhetoric and focus on trying to strike a deal with the Chinese (in which case, the economic cycle may be extended further)? Or will he dial up the pressure in a bid to position himself as defender of the U.S. economy ahead of next year's presidential election (in which case, brace yourself for further volatility)?

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

T.RowePrice®

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.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

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.

China—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

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 ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

Hong Kong—Issued by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

Malaysia—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

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.

Philippines—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

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.

South Africa—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

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

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

UK—This material is issued and approved 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.

© 2019 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.