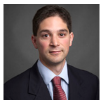
Navigating a Challenging Environment for Growth Stocks

We are positioned relatively defensively amid rate headwinds

May 2022

KEY INSIGHTS

- Large-cap growth stocks have struggled as Russia's invasion of Ukraine has compounded interest rate and inflation fears.
- Our price discipline led us to miss out on some of the market's most highly valued stocks over the past couple of years but has been a tailwind recently.
- We remain positioned relatively defensively as we expect growth stock valuations to move back more in line with longer-term averages.



Taymour Tamaddon
Portfolio Manager, US Large-Cap Growth Equity Strategy

While multiyear gains for large-cap growth stocks were fueled in part by innovation and earnings growth, a highly accommodative Federal Reserve and strong investor sentiment propelled segments of the market to extreme valuations. To date in 2022, many growth stocks have undergone a sharp correction driven by rising interest rates, inflation, and the Russian invasion of Ukraine.

T. Rowe Price has been investing in growth stocks since 1950, and our total large-cap growth equity assets under management exceed USD 343 billion (as of March 31, 2022).[1] Our extensive U.S. small-/mid-cap and non-U.S. research and portfolio management resources further complement our large-cap growth investing activities. Our experience shows that companies positioned to exploit change are among the most durable growth investments.

Taymour Tamaddon's investment experience began in 2003, and he has been with T. Rowe Price since 2004. Prior to this, Taymour was employed by Amazon.com in the areas of finance and merchandising and was previously employed by Booz Allen Hamilton as a consultant. Taymour earned a B.S., cum laude, in applied physics from Cornell University and an M.B.A. from Dartmouth College, Tuck School of Business, where he was an Edward Tuck Scholar with high distinction.

In this Q&A, Taymour discusses the current environment for large-cap growth stocks, his outlook for the asset class, and how he is positioning the portfolio in response.

[1] The combined U.S. Large-Cap Growth Equity assets managed by T. Rowe Price Associates, Inc. and its investment advisory affiliates.

Q: How would you summarize the market environment for growth stocks?

The last five years have been unprecedented in many ways. Over that period, large-cap growth stocks have seen their strongest returns since the late 1990s. The Russell 1000 Growth Index has also become highly concentrated. At their peak last August, the top five stocks by market capitalization accounted for nearly 40% of the index. Meanwhile, expanding multiples, rather than earnings and cash flows, have driven most of the index's appreciation. In sum, we're going through a highly unusual period in which multiple appreciation has been driving the preponderance of the strong returns of a very concentrated index.

Q: How has this environment affected your investment strategy?

We focus on estimating a company's growth rate, durability, and growth potential—and correspondingly spend much less time thinking about how its multiple might evolve. This is based on our belief that the biggest durable advantage you can have as an investor is correctly analyzing a company's potential earnings and free cash flow growth.

As part of this process, we develop three-year price targets for a stock, which helps prevent us from selling a position either much too early or much too late. Many large-cap growth stocks have well exceeded our price targets in recent years, encouraging us to sell and leading us to miss out on some of their spectacular gains; over the first quarter, however, this price discipline helped our relative performance.

Q: What was COVID's impact on the portfolio's relative performance?

We correctly anticipated many of the first-order impacts of the virus on stocks in our investment universe—to take one example, the boost it would provide online auto retailers. As it turned out, however, the second-order impacts of the virus—in terms of the massive fiscal and monetary relief efforts—played a much larger role in driving markets. Extremely low interest rates played a key role in favoring the fastest-growing stocks and pushing their multiples well past our price targets.

Q: What are your thoughts on two key growth markets: electric vehicles (EVs) and financial technology (fintech)?

There is a lot of excitement around EVs, and valuations are extended, in some cases. We still believe the industry is ripe with opportunity for investors; we just think some of the best prospects lie beyond the high-profile names, such as Tesla. In particular, we are especially interested in the crucial EV supply chain. Two of our recent investments have been in smaller, private companies that we think have long growth runways in the resource-constrained battery market. One provides battery recycling services, and the other provides a technology that improves battery performance.

A word about Rivian: The stock has pulled back dramatically from its highs shortly after its IPO last November, and it took a sizable toll on our first-quarter performance. If the company can leverage its contract to supply delivery vehicles to Amazon and dominate the embryonic EV truck market, we still see considerable upside potential. Of course, that's not guaranteed.

In fintech, we are interested in some of the legacy payments firms. These companies are investing in new technologies and seem poised to survive and possibly thrive—but they still trade at a healthy discount to the overall market because investors are skeptical that they can keep up with change and new entrants in the industry. I see some parallels with Microsoft, which some were prepared to write off about six years ago because of competition from Amazon Web Services and others.

> Many executives are telling me that they plan to implement additional price increases...

Q: How is Russia's invasion of Ukraine likely to affect growth stocks?

At the start of 2022, I was hopeful that inflation would moderate meaningfully in the second half of the year, but I now think the increases in oil prices and other commodities following Russia's invasion are likely to keep it elevated for the duration of 2022. Many executives are telling me that they plan to implement additional price increases, if they haven't already.

The war is also going to have an impact on consumer confidence and, therefore, spending. The war is already weighing on consumers in Eastern Europe, of course, but we're also seeing early signs of an impact on consumer attitudes in Western Europe. How it will affect the U.S. consumer is harder to gauge given that year-over-year comparisons are already muddied by the stimulus checks sent out in the spring of 2021.

Q: What is your outlook for the market given these headwinds?

I envision two scenarios. In the first, investors anticipate a coming recession as inflation persists and the Fed reacts, meaning valuations continue to compress over the next three to six months. In this scenario, given our long-term orientation, I would position the portfolio more aggressively.

In the second, the Fed engineers a soft landing, raising rates enough to cause inflation to decelerate but not so much to harm the economy. In this scenario, valuations may recover a bit from current levels and growth stocks could do pretty well over the next 12 to 18 months. But we would still expect growth stock valuations to normalize sometime over the next three years—keep in mind that, even after the recent pullback, aggressive growth stock valuations are still sitting at roughly 2019 levels. Exactly when and how quickly is very difficult to predict, however.

Q: How is this outlook reflected in your positioning?

The portfolio remains positioned defensively in this environment, although still in line with its growth mandate. We have allocated a larger-than-usual part of the portfolio to companies less sensitive to interest rates or economic conditions, such as managed care companies. We also like discount retailers, which may even benefit from an economic slowdown and more cautious consumers.

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

Risks

The following risks are materially relevant to the portfolio.

Small and mid-cap—Small and mid-size company stock prices can be more volatile than stock prices of larger companies.

General Portfolio Risks

Equity—Equities can lose value rapidly for a variety of reasons and can remain at low prices indefinitely.

ESG and sustainability—ESG and Sustainability risk may result in a material negative impact on the value of an investment and performance of the portfolio.

Geographic concentration—Geographic concentration risk may result in performance being more strongly affected by any social, political, economic, environmental or market conditions affecting those countries or regions in which the portfolio's assets are concentrated.

Hedging—Hedging measures involve costs and may work imperfectly, may not be feasible at times, or may fail completely.

Investment portfolio—Investing in portfolios involves certain risks an investor would not face if investing in markets directly.

Management—Management risk may result in potential conflicts of interest relating to the obligations of the investment manager.

Market—Market risk may subject the portfolio to experience losses caused by unexpected changes in a wide variety of factors.

Operational—Operational risk may cause losses as a result of incidents caused by people, systems, and/or processes.

INVEST WITH CONFIDENCE℠

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

T. Rowe Price®

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 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—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.

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. (UEN: 201021137E), 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.

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.

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.

ID0005034 (05/2022)
202205-2179198