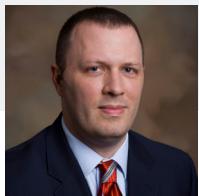




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September 2018

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The Communication Services Sector **CLASSIFICATIONS CHANGE TO REFLECT THE WAY WE NOW COMMUNICATE**

KEY POINTS

- Perhaps no innovations have had more impact in recent decades than the Internet and wireless communications. The communications and technology industries are converging.
- Reflecting these shifts, the Communications & Technology Fund has invested heavily in media companies while treading carefully in the traditional telecommunications sector.
- Morgan Stanley Capital International (MSCI) is creating a new communication services sector, effective September 28. The new sector will replace the telecommunication services sector.
- While we are happy to see these long-overdue changes, we will continue to search outside the new sector for companies that are best leveraging communications technology.

A basic truth of investing is that the market is an organism that is evolving constantly over time. The fortunes of companies are in constant flux and, over long periods, even entire industries can rise and fall. In one stark example, General Electric, for years the most highly valued company in the U.S. and an original component of the Dow Jones Industrial Average, was recently dropped from the benchmark after losing half of its value in 2017.

INTERNET AND WIRELESS RESHAPE COMMUNICATIONS

Globalization, demographic change, and other factors all play a role in the “creative destruction” that constantly reshapes the economic landscape, but innovation is clearly the primary driver. Perhaps no innovations have had such widespread impact over the past few decades than

the growth of the Internet and wireless communications. With each passing year, it has become clearer that the twin revolutions that gathered force in the early 1990s had some impact on almost every industry. But they completely remade how individuals and businesses connect with each other—whether to share news, sell products, or entertain.

Consider how differently we communicated in 1993, when T. Rowe Price opened its Media & Telecommunications Fund—recently renamed the Communications & Technology Fund. At that time, newspapers accounted for 32% of total U.S. advertising dollars, only 6% of the U.S. population had a mobile phone, and the consumer Internet as we know it didn’t even exist. Much has changed over the last quarter century. Today, newspapers account for only 4% of

total U.S. advertising dollars, mobile phone penetration has grown to 95% of the U.S. population, and nearly the same proportion is online (Source: MAGNA, Raymond James, Pew Research as of June 30, 2018).

New industries and companies have sprung up to seize the opportunities created by changing communications technologies and the Internet, in particular. Indeed, Internet companies account for five of the top 10 companies in the world by market capitalization, by last count (as of September 21, 2018; source: Statista, Reuters). There are also a number of areas in our investment space where industries are converging. Telecommunications and Internet infrastructure are becoming more intertwined. Enterprise technology and Internet platform companies are also overlapping, most notably in the case of Amazon's cloud services company, Amazon Web Services. Most visibly to consumers, media, video, and advertising are increasingly being subsumed by Internet players.

THE COMMUNICATIONS & TECHNOLOGY FUND HAS EVOLVED WITH TECHNOLOGY

This changing landscape has long been reflected in the Communications & Technology Fund. My predecessors

and I cannot claim to have foreseen all these changes, much less the precise ways they would deliver success to some companies while driving others out of business. From the beginning, however, the fund reflected an awareness that the "communications" sector meant far more than the major telephone companies and their suppliers. For this reason, we invested heavily in the media companies that were leveraging the growing ease of communicating with the public, while treading carefully in the traditional telecommunications sector, which has shrunk steadily since the late 1990s.

Chinese Internet firms long have been a particular focus of the fund due both to their huge domestic market and their position at the leading edge of innovation. Because the Internet and mobile telephony came along early in the maturation of the Chinese capitalist economy, savvy platform companies have not had to deal with legacy infrastructure and consumer habits to the same extent as their peers in the U.S. and other developed markets. As a result, Chinese firms such as Alibaba and Tencent not only have had more room to grow their penetration in the core advertising and e-commerce markets, but also have been able to pioneer in areas such as financial services and gaming. China has also been especially adept at recreating

the successful attributes of Silicon Valley, including emulating its culture of innovation, its ready pool of available capital, and its embrace of risk-taking and consequent tolerance for failure. We anticipate that China's leading communication services firms will remain at the leading edge of innovation and potentially challenge U.S. firms in other global markets.

Companies with Internet-based business models now account for roughly half of the fund's assets; approximately 20% of the fund is invested in companies directly related to the wireless business, and we own no newspaper companies. This is because, over these past 25 years, my predecessors and I have sought to evolve the fund's holdings to reflect not just the sector's current state, but what we think it will look like in the future.

THE NEW COMMUNICATION SERVICES SECTOR

These profound changes in the market landscape will soon get official recognition, as well. MSCI, a leading provider of market indexes, has recently announced that it will be making the biggest changes to its sector classifications in history by introducing a new communication services sector, a change expected to take effect on September 28. The

FIGURE 1: The Communication Services Sector Under MSCI Classification

Effective September 28, 2018

Sector	Industry Group	Industry	Subindustry
Communication Services	Telecommunication Services	Diversified Telecommunication Services	Alternative Carriers
		Telecommunication Services	Integrated Telecommunication Services
		Wireless Telecommunication Services	Wireless Telecommunication Services
	Media and Entertainment	Media	Advertising
			Broadcasting
			Cable and Satellite
			Publishing
		Entertainment	Movies and Entertainment
			Interactive Home Entertainment
			Interactive Media & Services

Sources: MSCI, S&P Dow Jones Indices.

new sector will absorb and replace the telecommunication services sector, which included only a handful of companies and accounted for only 2% of the S&P 500 Index as of June 30, 2018.

The new communication services sector will expand to also include many of the companies that previously sat in the consumer discretionary sector, such as the traditional media and cable firms, as well companies currently in the technology sector—indeed, it is likely that firms brought over from other segments will form over 80% of the new sector. As a result, the new communication services sector will now account for over 10% of the S&P 500 Index after these changes, making it the fifth-largest sector in the S&P 500 Index. The new sector will also help balance sector weightings by trimming the size of the dominant technology sector from around 26% of the index to roughly 21%.

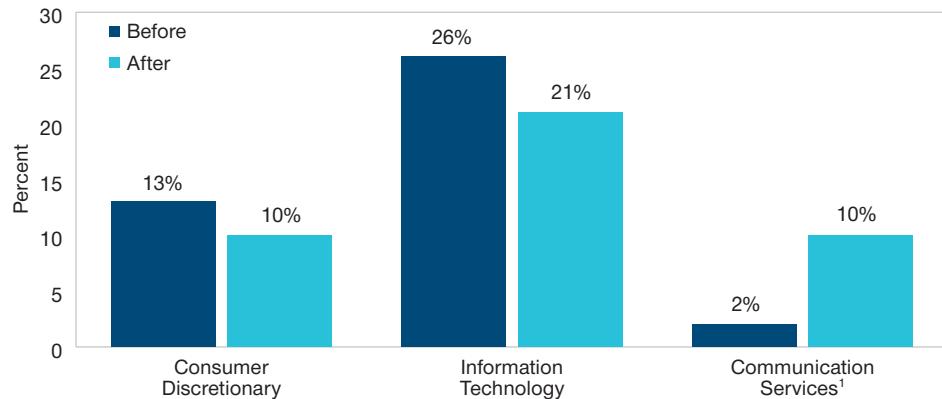
The changes should provide considerable clarity to investors. As it stands now, companies in our investment universe are scattered across various MSCI sectors. For example, cable companies are now in the consumer discretionary sector, while wireless companies are in the telecommunication services sector—despite the fact that these two industries are steadily converging. Both will now fall under the communication services umbrella.

Similarly, many of the traditional media companies are currently in the consumer discretionary sector, while

FIGURE 2: S&P 500 Index Weights

Before and After Introduction of the Communication Services Sector

Based on weightings as of June 30, 2018



¹Replaces the telecommunication services sector.

Source: S&P Dow Jones Indices.

companies such as Alphabet (Google) and Facebook are placed in technology. This also makes little sense as Google and Facebook are taking share from the traditional media companies and earn the majority of their revenues from advertising. Traditional media firms such as Disney, along with Internet-based providers, such as Netflix, will now be moved into the media and entertainment industry group under the communication services sector. Meanwhile, Alphabet and Facebook will sit next to them in the Internet services industry (and make up almost half of the sector's market capitalization). Parts of the sprawling business of Amazon would undoubtedly fit into the new sector as well, but the company will remain in the consumer discretionary sector, anchored there by its original online retail business.

OUR WILLINGNESS TO LOOK BEYOND STANDARD SECTOR CLASSIFICATIONS

Our success over the past 25 years owes much to our decision not to run our fund in accordance with a specific benchmark as set forth by these sector classifications. Instead, we have looked at the broader landscape and invested in companies from a bottom-up perspective, which has caused us to end up with a resulting exposure that we think reflects where the world is going. If that means we look a lot different than our peers or benchmark, so be it. Indeed, while we are happy to see these long-overdue changes from MSCI, we will continue to search outside the new communication services sector in an effort to find the companies that are best leveraging communications technology.

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